
Centre for International
Governance Innovation

SPECIAL REPORT

Regional Financial Arrangements and the International Monetary Fund Sustaining Coherence in Global Financial Governance

C. Randall Henning



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C. Randall Henning is professor of international economic relations in the School of International Service at American University in Washington, DC. He has published widely in the fields of global governance and international and comparative political economy, focusing recently on institutional arrangements for crisis finance, regional integration and Europe's monetary union. He is author, co-author or editor of numerous books, including *Tangled Governance: International Regime Complexity, the Troika, and the Euro Crisis* (Oxford University Press, 2017), *Global Financial Governance Confronts the Rising Powers* (CIGI, 2016, with Andrew Walter), *Fiscal Federalism: US History for Architects of Europe's Fiscal Union* (Bruegel, 2012), *Accountability and Oversight of U.S. Exchange Rate Policy* (Peterson Institute, 2008), *East Asian Financial Cooperation* (2002), *Transatlantic Perspectives on the Euro* (Brookings Institution, 2000) and *Currencies and Politics in the United States, Germany, and Japan* (Peterson Institute, 1994). He has also published articles in several academic journals. Among other activities, he led the financial cooperation research team for CIGI and INET's New Thinking and the New G20 project. His previous appointments include service as visiting fellow at the Peterson Institute for International Economics. Currently, he is conducting comparative projects on the fragmentation of global governance and the political economy of regime complexity.

About Global Economy

Addressing the need for sustainable and balanced economic growth, the global economy is a central area of CIGI expertise. The Global Economy initiative examines macroeconomic regulation (such as fiscal, monetary, financial and exchange rate policies), trade policy and productivity and innovation policies, including governance around the digital economy (such as big data and artificial intelligence). We live in an increasingly interdependent world, where rapid change in one nation's economic system and governance policies may affect many nations. CIGI believes improved governance of the global economy can increase prosperity for all humankind.

Acronyms and Abbreviations

ADB	Asian Development Bank	IFIs	international financial institutions
AMF	Asian Monetary Fund	IMF	International Monetary Fund
AMRO	ASEAN+3 Macroeconomic Research Office	IRC	International Relations Committee
ASEAN+3	Association of Southeast Asian Nations plus China, Japan and South Korea	MOU	memorandum of understanding
BRICS	Brazil, Russia, India, China and South Africa	NAB	New Arrangements to Borrow
BSA	bilateral swap agreements	OMT	Outright Monetary Transactions
CACs	collective action clauses	PCI	Policy Coordination Instrument
CMIM	Chiang Mai Initiative Multilateralization	PL	Precautionary Line
DSA	debt sustainability analysis	PLL	Precautionary and Liquidity Line
EAP	Exceptional Access Policy	RFAs	regional financial arrangements
ECB	European Central Bank	S&P	Standard and Poor's
EFSSF	European Financial Stability Facility	SBA	Stand-By Arrangement
ELDMB	Executive Level Decision Making Body	SDR	Special Drawing Right
EMDCs	emerging market and developing countries	SF	Stability Facility
EMF	European Monetary Fund	SGP	Stability and Growth Pact
EMU	Economic and Monetary Union	SLS	Short-term Liquidity Swap
EPG	Eminent Persons Group	SRF	Single Resolution Fund
ESF	Exchange Stabilization Fund	SSM	Single Supervisory Mechanism
ESM	European Stability Mechanism		
FCL	Flexible Credit Line		
FLAR	Latin American Reserve Fund (Fondo Latinoamericano de Reservas)		
G7	Group of Seven		
G20	Group of Twenty		
GFSN	global financial safety net		
IEO	Independent Evaluation Office		

Executive Summary

Cooperation and competition among regional financial arrangements (RFAs) and the International Monetary Fund (IMF) increasingly determine the effectiveness of the global financial safety net (GFSN), which many observers fear is becoming fragmented. Overlap among these crisis-fighting institutions has important benefits but also pitfalls, including with respect to competition, moral hazard, independence, institutional conflict, creditor seniority and non-transparency. The study reviews the RFAs in Latin America, East Asia and Europe to assess their relationships with the IMF and address these problems. Among other things, it concludes: institutional competition, while harmful in program conditionality, can be beneficial in economic analysis and surveillance; moral hazard depends critically on institutional governance and varies substantially from one regional arrangement to the next; secretariats should be independent in economic analysis, but lending programs should be decided by bodies with political responsibility; and conflicts among institutions are often resolved by key member states through informal mechanisms that should be protected and developed. Findings of other recent studies on the GFSN are critiqued. Architects of financial governance should maintain the IMF at the centre of the safety net but also develop regional arrangements as insurance against the possibility that any one institution could be immobilized in a crisis, thereby safeguarding both coherence and resilience of the institutional complex.

Introduction

Global financial governance confronts challenges that are perhaps more severe than any it has faced since the founding of the Bretton Woods institutions 75 years ago. Nationalist political movements threaten the commitment of several advanced and emerging-market countries to global multilateral institutions, while at the same time the proliferation of institutions has made their coordination substantially more complicated. When the global economic cycle begins a downturn, any weakening of international financial institutions or the arrangements by

which they cooperate would impair the ability of the system as a whole to combat crises and stabilize the world economy. It is important to ensure that these institutions are not only healthy, but also equipped to cooperate effectively with one another to deliver financial assistance.

The administration of US President Donald Trump has for the time being blocked the IMF, which has historically been at the centre of global financial governance, from receiving a quota increase (US Treasury 2018). Member governments that wish to support the multilateral institution will instead renew the arrangements by which the IMF can borrow from its members. Quotas are not being reweighted in favour of emerging market and developing countries (EMDCs) during the fifteenth review, perpetuating under-representation of fast-growing members. With the recent appointment of another American as president of the World Bank and a European as managing director of the IMF, the abandonment of the convention by which US and European citizens lead these institutions in favour of well-qualified officials from other parts of the world appears to be a receding prospect.

Many EMDCs have hedged against resistance to modernizing global financial governance on the part of the United States and some European countries by developing alternatives to the IMF over the last two decades. These countries have accumulated international reserves unilaterally, entered into currency swap agreements bilaterally and created financial arrangements regionally and cross-regionally. For their part, euro-area member states created new facilities for financial assistance during the European debt crisis of 2010–2013. Together with the IMF, these financial facilities comprise an international regime complex¹ for crisis finance that, in the discourse on financial governance, is often called the global financial safety net.

One important question at this juncture is how EMDCs and euro-area member states will develop and use the new institutional options now at their disposal. These countries have by no means abandoned the IMF; they continue to support and draw from that global multilateral institution. However, if the United States and other leading member states refuse to update the

¹ The growing international relations literature on regime complexity includes, but is not limited to, Alter and Raustiala (2018); Morse and Keohane (2014); Abbott, Green and Keohane (2016); Lipsky (2017); and Henning and Pratt (2019).

Fund and augment its resources, these countries will have strong incentives to further build up alternative institutions, including their RFAs.

The pattern raises the prospect that someday the functional equivalent of the IMF might be created within each region — an “Asian Monetary Fund,” a “European Monetary Fund,” a “Latin American Monetary Fund” and so forth. Proposals for such funds have been advanced in each of these three regions. A “world of regional monetary funds” would challenge the IMF, if not substantially displace it from its position at the centre of the safety net. Such a world might in fact be unlikely, but the quest to diversify the financial safety net will endure and extend to the development of central bank swaps and other facilities.

Proliferation of these financial arrangements and institutions substantially increases the complexity of the financial safety net. Such complexity has a number of benefits — it augments the total resources that can be brought to bear on a crisis and protects the ability of the system as a whole to respond to crises against the capture (or starvation) of any one of its parts by a narrowly self-serving government. Redundant layers of the safety net serve as insurance against the immobilization of any one layer. But, considerable though such advantages might be, complexity is ultimately beneficial only if the different elements are effectively coordinated and thus do not interfere with one another in a crisis. Such coordination cannot be taken for granted — especially when member states that stand behind the institutions are embroiled in disputes over trade, immigration or security as they are now.

This special report addresses the problem of coordinating the RFAs and the IMF. The next section reviews recent debates over global financial governance and its reform, including the reports of several blue-ribbon commissions and official working groups. The third section then enumerates the general risks and promises of institutional overlap and complexity, setting the stage for dissecting specific threats in subsequent sections. The fourth section reviews recent developments in the RFAs in Latin America, East Asia and the euro area, including their present challenges and recommendations for strengthening them. The fifth section addresses the recent evolution of the IMF insofar as it relates to engagement with the RFAs. This section forgoes extended discussion of the history of the

development of the RFAs, the IMF and the rest of the GFSN, as these can be found elsewhere.²

In the sixth section, the report assesses the dangers posed by the overlap of crisis-fighting institutions and recommends strategies for pre-empting or managing them. It addresses many questions, for example: Should institutions always cooperate or are there areas where it is safe, even beneficial, to allow them to compete? Does a multiplicity of institutions in crisis finance increase the threat of moral hazard? Does it make crisis finance more susceptible to capture by banks and other private-sector institutions? How should conflicts among institutions be resolved? Which institutions should have seniority as creditors in a complex such as the GFSN? The final section concludes the report.

A substantial portion of scholarship on RFAs is motivated by the question of whether they should be promoted as counterweights to the IMF or discouraged on the reasoning that they compete with, and complicate the work of, the IMF. Whether an RFA or the IMF is the better vehicle for a financial rescue program for a crisis-stricken country, or whether the two institutions would best cooperate in administering such a program, depends on several prior questions, however. General statements about the superiority of one approach over the other in providing financial stability, the ultimate purpose of the safety net, are not defensible. Rather than advocating for either RFAs or the IMF, therefore, the present report examines factors that illuminate the strengths and weaknesses of each and the pathways toward cooperation. RFAs and the IMF are, in principle, complementary. But complementarity does not evolve automatically — it must be actively designed into the institutions as they evolve within the complex.

The present study is distinguished from the recent reports in four respects. First, while it discusses the strategic choices facing each of the RFAs in their regional context, the study focuses on the interaction between each of them and the incumbent global multilateral institution, the IMF. Second, this study has the luxury of being more explicit about the political economy of financial cooperation — both in the region and within the global multilateral institution — than some of the official reports and economic studies.

2 See the scholarship cited in the following section.

Third, while the study identifies ways to advance the substantive effectiveness of institutional cooperation, it recognizes that states seek other goals as well, among which control is especially important, and bring institutions together to constrain “agency drift.” Finally, and relatedly, the report emphasizes the need for recommendations that are not only desirable from a technocratic point of view, but also feasible from a political economy standpoint, given the intergovernmental character of the institutions for crisis finance.

Debate over Financial Governance

Concern over the coherence of financial governance has spawned a cottage industry of blue-ribbon panels and expert studies over the future of these institutions and how they should be “knitted” together. These include studies by the IMF and RFAs themselves, as well as the European Central Bank (ECB) and independent scholars.³ This section summarizes the findings of several of these studies and elaborates on the distinction between technocratic and political-economy prescription.

Reports and Perspectives

Building on guidelines developed within the Group of Twenty (G20), the IMF offers six principles to guide its relationships with regional arrangements (see Boxes 1 and 2). The first of these is that mutual engagement must respect the independence of the institutions from one another. The other five principles state that institutional mandates and expertise should guide institutions’ roles in cooperation; collaboration should be ongoing; program terms and conditions should be consistent from the borrower’s standpoint; the Fund’s engagement should be even-handed across the regions; and the IMF’s preferred creditor status must be respected.

The IMF also lays out two overall visions by which it would collaborate with RFAs in the future — the “lead agency” model and the “coherent program design” model. The choice of the model would depend on the characteristics and capabilities of the RFA and the possibilities for a reasonably clear division of labour. Where “some division of labour” between the IMF and the RFA is possible, the two institutions would defer to one another in their respective areas of comparative advantage when designing and implementing programs. Where the overlaps between the capabilities and mandates of the two institutions are so large as to make selective deference infeasible, the coherent-design model would apply. The latter would see early engagement between the institutions, and the Fund would adhere to its macroeconomic framework and debt sustainability analysis (DSA) (IMF 2017a, 2, 17, 22, 25). Authors from the RFAs call for clarification of the modalities, division of labour and combined use of lending instruments (Cheng et al. 2018, 16–18). However, it would be fair to surmise that the IMF expects to follow the coherent-design model in European contingencies and to serve as the lead agency everywhere else.

The G20 convened an Eminent Persons Group (EPG) on Global Financial Governance under the leadership of Singapore’s Deputy Prime Minister Tharman Shanmugaratnam, and it delivered its report, *Making the Global Financial System Work for All*, in October 2018.⁴ Calling generally for cooperation, the EPG report advocated strengthening the coordination of multilateral development institutions; facilitating countries’ openness to international capital markets; and integrating the surveillance activities of the IMF, the Financial Stability Board and the Bank for International Settlements. With respect to the IMF and RFAs specifically, the report recommended establishing a “clear assignment of responsibilities and protocols for joint actions,” which would include “discussions of coherence of ex-post conditionality” and liquidity needs. The group wanted to keep alive proposals for an IMF liquidity facility, which could be coordinated with similar facilities offered by the RFAs. The EPG recommends that the Articles of Agreement of the IMF, the World Bank and other multilateral development banks be amended to delegate greater decision making — presumably with respect to design and approval

3 In addition to the work cited below, see Miyoshi et al. (2013); Rhee, Sumulong and Vallé (2013); Eichengreen (2012); Ocampo (2017); Grabel (2017); Henning (2017); Eichengreen, Lombardi and Malkin (2018); Triggs (2018); Krug and Grimes (2019); and Malone and Medhora (2019).

4 Hereafter referred to as the “G20 EPG Report,” or simply “EPG Report.”

Box 1: G20 Principles for Cooperation between the IMF and Regional Financing Arrangements

In November 2010, G20 Leaders tasked G20 Finance Ministers and Central Bank Governors to explore “ways to improve collaboration between RFAs and the IMF across all possible areas.” Based on contributions by the EU and by ASEAN+3 countries members of the G20, the following non-binding broad principles for cooperation have been agreed. Also, collaboration with the IMF should be tailored to each RFA in a flexible manner in order to take account of region-specific circumstances and the characteristics of RFAs.

Principle 1: An enhanced cooperation between RFAs and the IMF would be a step forward towards better crisis prevention, more effective crisis resolution and would reduce moral hazard. Cooperation between RFAs and the IMF should foster rigorous and even-handed surveillance and promote the common goals of regional and global financial and monetary stability.

Principle 2: Cooperation should respect the roles, independence and decision-making processes of each institution, taking into account regional specificities in a flexible manner.

Principle 3: While cooperation between RFAs and the IMF may be triggered by a crisis, ongoing collaboration should be promoted as a way to build regional capacity for crisis prevention.

Principle 4: Cooperation should commence as early as possible and include open sharing of information and joint missions where necessary. It is clear that each institution has comparative advantages and would benefit from the expertise of the other. Specifically, RFAs have better understanding of regional circumstances and the IMF has a greater global surveillance capacity.

Principle 5: Consistency of lending conditions should be sought to the extent possible, in order to prevent arbitrage and facility shopping, in particular as concerns policy conditions and facility pricing. However, some flexibility would be needed as regards adjustments to conditionality, if necessary, and on the timing of the reviews. In addition, definitive decisions about financial assistance within a joint programme should be taken by the respective institutions participating in the programme.

Principle 6: RFAs must respect the preferred creditor status of the IMF.

Source: G20 Finance Ministers and Central Bank Governors (2011).

Note: The ASEAN + 3 consists of the 10 Southeast Asian countries of ASEAN (the Association of Southeast Asian Nations) plus China, Japan and South Korea.

of programs and projects — to the management of each institution (G20 EPG 2018, 1-27).

José de Gregorio et al. (2018) address the relationship of the IMF to RFAs in the context of an ambitious report, *IMF Reform: The Unfinished Agenda*.⁵ They propose that the IMF “negotiate formal agreements with current and future RFAs and consider a binding arbitration procedure to resolve disagreements” (ibid., 53-55). The authors advocate that the IMF create a fast-qualifying, non-conditional facility that would effectively substitute for bilateral swap agreements (BSAs). They also propose to reorganize the governance of the IMF along the lines of an independent central

bank, wherein the management team would make decisions and take responsibility for program design and disbursements. The management team would be selected by a new voting procedure and accountable to an executive board that could be made non-resident and convene six to eight times a year (ibid., xx-xxiii, 72-73). The authors base their argument for independence on the IMF’s susceptibility to time inconsistency: it might declare *ex ante* that it will not lend to countries whose debt is not sustainable, such as Greece, but in the event will nevertheless succumb to pressure to lend from countries that would otherwise suffer from a debt restructuring.

By contrast, the Independent Evaluation Office (IEO) of the IMF expressed concern that distancing program approval and lending decisions from

⁵ Hereafter referred to as the “Geneva Report” for the series in which it appears.

Box 2: The IMF's Six Principles for Strengthening IMF-RFA Collaboration

Principle 1: Independence. The modalities of engagement should respect the independence of the Fund and the RFA. Decisions by the Fund and the RFA must comply with their own policies and governance structures.

Principle 2: Mandates and technical expertise. The roles played by each institution in any particular form of engagement (e.g., surveillance, lending) should reflect their respective mandates and purpose (e.g., in a Use of Fund Resources context, the Fund's focus is on resolving short- to medium-term BoP [balance of payment] needs), technical expertise, comparative advantage, legal and governance structures, and constraints imposed by any regional legal frameworks (e.g., treaty obligations in the EU).

Principle 3: Early and ongoing cooperation. The Fund and RFAs should strive to collaborate on an ongoing basis — to strengthen the capacity for crisis prevention — and work together efficiently and quickly when a financing need arises.

Principle 4: Consistency and limited arbitrage. Collaboration in lending for the Fund requires consistency — in the sense of a single program, belonging to the member country, which may be supported by multiple creditors.

To reduce incentives for facility shopping, the modalities and policies relating to program conditionality and monitoring should be transparent and predictable, and explicit links to Fund support should be considered for high levels of RFA financing. Finally, public communications by the Fund and the RFA should be coordinated and consistent.

Principle 5: Evenhandedness. The Fund's engagement with RFAs should be evenhanded across RFAs and between RFA members and other Fund members. This principle of evenhandedness would in practice apply by "activity" and hence (since the scope of activities differs across RFAs) it does not necessarily imply identical treatment for each RFA.

Principle 6: Fund's preferred creditor status. Preferred creditor status reflects an international consensus (originating in the Paris Club) that the Fund is excluded from debt restructuring processes. This must be maintained, as it is derived from the IMF's unique role within the GFSN. Moreover, even if the Fund is invited to contribute to a program, the Fund's participation is ultimately an issue for the Fund to decide.

Source: IMF (2017f).

national governments would weaken the Fund's accountability and legitimacy, not strengthen them (IEO 2018). The EPG, for its part, takes a nuanced view on governance within the international financial institutions. The executive boards should focus on strategic priorities for the institution and hold management to account for advancing them, although IMF "surveillance and lending programs may involve broader considerations that require Board discussion" (G20 EPG 2018, 73–75, footnote 83, as discussed below). Such reforms impact the ability of the IMF to collaborate with RFAs.

Meanwhile, Beatrice Weder di Mauro and Jeromin Zettelmeyer (2017) raise the alarm against moral hazard when the IMF and RFAs are brought together. They argue that the IMF failed to anchor the European Stability Mechanism

(ESM) against drift toward "soft financing" in the case of Greece and advocate that RFAs develop their own policy frameworks with safeguards against lending to countries with unsustainable debt. Authors located at the ECB raise similar concerns (see, for example, Scheubel and Stracca 2016; ECB 2016; International Relations Committee Taskforce on IMF Issues 2018⁶).

⁶ Hereafter referred to as the "IRC Taskforce."

Technocratic versus Political Prescription

Most of the reports on global financial governance, including the Geneva and G20 EPG reports, are guided by an approach that is technocratic, seeking to advance financial stability and the economic welfare of the global system. Normatively speaking, they resist the constraints that are imposed on institutional design and interaction by virtue of the intergovernmental nature of these organizations. Revealingly, the EPG Report states, “Policy thinking on the issue has often been shaped by whether one sits in [capital] sending or receiving countries. *We have to move beyond this*” (G20 EPG 2018; emphasis added).

If the resources for crisis finance were to come from non-state actors, global governance might indeed “move beyond this.” But that is not realistic over the relevant planning horizon. For the time being, the relationships among the IMF and RFAs must be designed with the understanding that national finance ministries and central banks will insist on control over the institutions — that is, within an intergovernmental paradigm. Rather than ask creditors and debtors to put aside their financial status, architects of governance must search for institutional pathways along which they can cooperate that are consistent with these interests — a pathway that might be narrow but, insofar as states’ interests do overlap, can be found.

Moreover, it is dangerous for architects of global financial governance to feign innocence of or otherwise ignore institutional politics. This is one of the greatest lessons of the euro crisis of 2010–2013. In Europe, monetary integration had gotten out in front of political integration, creating severe vulnerabilities. While it is possible to envision a more complete monetary union, one in which risk is better shared across the membership, this would require deep changes in euro-area governance. If governance does not catch up — and this remains to be seen — monetary integration could be endangered once again.

Fundamentally, international financial institutions are created and maintained by and responsible to their member states. For various reasons, however, institutions often migrate away from the preferences of powerful states, a tendency called “agency drift.” The euro crisis shows that states can use one institution to correct such drift and reassert control over other institutions (Henning 2017;

2019). Involving multiple institutions in financial rescues, as in the case of the “troika,” can give rise to disputes that can be costly, but states prioritize control instead. When institutional disagreements become intense and create deadlock, key states, usually creditors, often mediate these disputes. In so doing, they put their thumb on the scale and tilt the outcome toward their preferences. Mediation is thus one way in which key states maintain control. States are reluctant to disintermediate themselves and, as a consequence, they *underinvest* in mechanisms that might otherwise better anticipate and resolve institutional conflict *ex ante*.

As a result, mechanisms of *ex ante* coordination of intergovernmental institutions are rarely, perhaps never, going to fully satisfy architects who take a functionalist approach to the design of complexes of institutions. When designing institutions and the relationships among them, architects of the safety net should identify what is both desirable *and* feasible — not simply one or the other — and they should *act* at the intersection of the two approaches, rational-technocratic and political-institutional.

Parenthetically, it should be noted that, although states in some emerging regions of the world originally created financial arrangements to bypass or constrain the IMF, the RFAs themselves are not immune to agency drift. So, the pivotal states in each region might use the IMF to constrain drift on the part of an RFA, rather than necessarily vice versa — as witnessed during the euro crisis.

General Risks and Promises of Institutional Overlap

To analyze the problems of overlapping jurisdiction of international institutions in crisis finance, this section considers the comparative advantages of global multilateralism and regionalism and then examines issues that can arise in their interaction. Its treatment is general, a prelude to examining the evolution of the three RFAs and the IMF in the two sections that follow.

Comparative Advantages

Global multilateralism in finance has the advantage, first, of drawing upon a universal risk pool. This is fundamentally important not only because such a pool can be large, but also because it is *universal*. Universalism ensures that financial outflows from a country experiencing a crisis are balanced by inflows to other countries in the same pool. Most of these capital flows move through the private sector and must be captured by the public sector in order to provide official assistance, which can be a formidable problem. But, when the private-public gap can be bridged, capital flows can be balanced within the pool, whereas they can escape systems that have only partial geographic coverage. A global institution, to put it another way, corresponds to the globalized nature of financial markets.

A global multilateral institution also comprehends the broadest possible range of country experience and problems, can derive lessons from this experience and can apply them to surveillance and new country programs. It can, in principle, maximize economies of scale in staff organization and economies of agglomeration across substantive areas of expertise. Finally, as a universal risk pool, the global institution might well be called upon to back up regional and other financial facilities and is, in this sense, a last resort, which has implications for the appropriate location of preferred creditor status.

The functional case for regionalism rests on the depth of economic integration at the regional level relative to the global level and the regional character of financial contagion. Economic and financial shocks propagate more readily among countries with deeper trade and financial connections, which coincide frequently, although not always, with spatial proximity. Under these circumstances, geographic neighbours have a stronger incentive than distant partners to invest in financial rescue facilities on a regional basis and maintain them. The regional character of crises is accentuated by spillover across functional areas, to trade, social conditions, foreign policy and regional politics.

Regional secretariats generally, although not necessarily always, have better local knowledge. In matters of surveillance, for example, they might have a better sense of "where the bodies are buried," where the vulnerabilities might be and what the domestic political obstacles may

be to overcoming them. Coming from within the region, officials might have greater legitimacy in dealing with member countries. Regional institutions that are relatively young do not carry the burden of a history of crisis interventions, or of the mistakes that might have been made along the way and the stigma associated with them.

However, regional arrangements have the relative disadvantage of a risk pool that is both narrower and less diversified than that of a global institution. Just as an insurance company would be ill advised to sell policies against hurricane damage only in the US state of Florida, regional arrangements alone are not likely to be effective insurance against financial crises that consume whole regions. Crises over the last few decades have exhibited a strong regional dimension, which is why most of them are referred to by their regional names — the "Asian financial crisis," the "European sovereign debt crisis" and so forth. So, while regional integration motivates the creation of RFAs, it can also motivate regions' links to the IMF.

Risks

Layering RFAs, the IMF and other elements of the financial safety net on top of one another gives rise to a number of potential problems.

The first problem is conceptually straightforward: the financial safety net covers some countries better than others. Nearly all countries are members of the IMF and can draw on it in cases of need. But IMF resources alone might not be sufficient to stabilize a liquidity shock that is systemic in nature, and the coverage of RFAs is incomplete. Many countries are not members of a regional arrangement, and some of those that are have access that is uncertain.⁷ Some countries get too little coverage, prompting them to self-insure with unilateral reserve accumulation excessively; other countries, by contrast, could at least in principle be receiving too much coverage, undercutting incentives to control risk.

Second, there is thus the possibility that complexity contributes to moral hazard, of which we can distinguish two types, private sector and official sector moral hazard. With the thickening of

⁷ See, for example, IMF (2017a), Sterland (2017a) and Triggs (2018). Adam Triggs analyzes the size of the safety net on a country-specific basis and surveys policy makers' views.

the safety net,⁸ private financial institutions could well lend and borrow in the expectation that the prospects for financial rescues by the official institutions have risen. If one institution is blocked, for one reason or another, crisis lending could be mobilized through an alternative channel. In this way, the proliferation of official institutions and facilities could stoke excessive private lending, excessive debt issuance and, eventually, larger crises. A similar argument could be made for official-sector moral hazard.

Third, complexity gives rise to multiple avenues for private capture of official institutions and the processes by which decisions on financial assistance are made.⁹ Private creditors are sometimes well placed to cajole, influence or threaten officials in order to manipulate the complex of institutions to their advantage — by, among other means, holding “innocent bystanders” hostage for bailouts. We should be alert to the possibility that, as one institution erects safeguards against abuse (such as the IMF’s lending framework and reprofiling requirements), lenders who have been imprudent (either private or official) simply exploit other institutions in the safety net. We should be sure, in other words, that redundancy in the safety net is not being used to “bypass” safeguards against private capture and moral hazard.

Fourth, with a larger number of potential sources of crisis finance, borrowers are more likely to shop around. Pakistan, for example, reportedly approached Saudi Arabia, China and the United Arab Emirates before finally turning to the IMF in October 2018 to negotiate a program. Creditor shopping has at least two potentially negative consequences: it delays the program and thus financing and adjustment; and it could possibly weaken the conditions attached to programs.

Such a weakening might be perceived to be beneficial, if IMF conditionality were excessively austere. In such case, augmenting IMF resources with bilateral or regional resources could be an appropriate complement to a more permissive adjustment path. But a weakening of conditions would *not* be beneficial if alternative

creditors stepped forward with poorly designed programs or if competition between elements of the safety net caused institutional officials to weaken the coherence of their program.

Fifth, the IMF wishes to guard against what could be called a “nightmare scenario.” In this scenario, a bilateral creditor or an RFA disburses to a borrower under stress with the understanding that the country faces a liquidity crisis, but mistakenly so. By the time that the creditor realizes the true extent of the need for fundamental adjustment, the crisis has deepened and metastasized to regional neighbours. The original borrower, and perhaps now other countries in the region, only *then* turns to the IMF for financing — by which time the scale of the adjustment problem has magnified, the options for dealing with it have narrowed and the costs have soared.

Again, there is a possibility that the IMF itself could also fail to correctly diagnose a problem of liquidity or fundamental adjustment, or fail to stem contagion to a borrower’s regional neighbours. A number of analysts argue that the IMF contributed to contagion in East Asia in 1997-1998 by underfunding programs and exacting excessive adjustment and currency depreciation (see, for example, Ito 2007; 2012; 2018). This line of argument leads to the debate over which institution delivers the most appropriate diagnosis and can design the better adjustment program, the IMF or the regional arrangement. Such a debate cannot be settled in the abstract. Suffice it to say for the moment that, in principle, member states have the right to create RFAs but that, as a practical matter, the IMF possesses an analytical capacity and breadth and depth of experience with such programs that is currently unparalleled.

Promises

Having multiple institutions operating in the financial crisis space has *benefits* as well as dangers. Complexity provides redundancy, which is especially useful when, for one reason or another, one institution is immobilized. Institutional partners bring additional resources to bear in financial rescues, both staff expertise and financial resources. Resource augmentation is especially important when those of the IMF could be declining yet financial markets remain globalized and capital-account crises prevail. A multiplicity of institutions introduces alternative diagnoses and prescriptions for economic problems. Although competition over

⁸ Conventionally, the GFSN has four main components: the IMF, RFAs, BSAs and international reserves held unilaterally.

⁹ This is related to, but conceptually different from, moral hazard. Capture can, in principle, occur even when excessive risk taking is not involved.

the terms of lending and policy conditionality in programs would be destructive, competition in analysis, forecasting and surveillance can benefit member states and improve economic outcomes.

To realize such benefits, and to avoid the pitfalls, however, institutions must be coordinated and competition constrained in activities where it is dysfunctional. As the institutions evolve over time, moreover, their interactions with others in the institutional complex for crisis finance must be anticipated. Rather than undergo reform as if they operate in isolation and later be thrown together to address crises, these institutions should be guided in their evolution by a design concept for the complex as a whole.

Reasonable success in coordinating most institutions in most crises has fed complacency with respect to organizing relations among the international financial institutions (IFIs). One might take the view that, although the institutions have conflicts, they can be made to work together effectively in the future. But the reason why institutional cooperation could be organized reasonably satisfactorily in the (increasingly distant) past is that the IMF was heavily influential, if not dominant, and, when it shared authority with European institutions in the euro crisis, leading member states were in a position to arbitrate conflicts among the institutions. Both of these conditions appear to be changing, and so renewed attention to the collaboration mechanisms of the Fund and regional arrangements is required.

Regions and Their Financial Arrangements

RFAs have emerged in most, but not all, regions of the world. The IMF (2017a, 6) defines them simply as “a financing mechanism backed by pooled resources through which a group of countries pledge common financial support to a fellow member in the event of external liquidity

needs or balance of payments difficulties.”¹⁰

Table 1 lists 11 institutions that qualify as RFAs. Notice, first, that they are quite heterogeneous: some have a mandate and the capacity for economic surveillance and analysis, but others do not. Some RFAs have mandates for economic integration of the region and economic development. The ESM, with a lending capacity of €500 billion, is very large, while others can mobilize only a few billion US dollars. The heterogeneity of RFAs complicates efforts to develop general protocols for other institutions’ engagement with them.

From among this set, the present section selects three arrangements for deeper consideration, those in Latin America, East Asia and Europe. The group encompasses substantial regional variation and ranges from small to large institutions, and thus captures most, if not all, of the major problems that are likely to arise in cooperation with the IMF. Although the European arrangements are embedded within a monetary union, which creates some unique features, the euro-area institutions nonetheless share challenges that are enough in common with those of the other RFAs to consider them together. The section emphasizes relatively recent development of these RFAs, the strategic questions confronting them and their evolving relationships to the IMF.¹¹

Latin America

The region’s financial arrangement is the Latin American Reserve Fund. The central banks of Bolivia, Colombia, Ecuador, Peru and Venezuela first created the Andean Reserve Fund in 1978 as a regional project that also included the creation of the Andean Development Corporation in 1970. In 1989, with the objective of expanding membership beyond the Andean region to the rest of Latin America, the members renamed the organization the Latin American Reserve Fund (FLAR, the acronym of the Spanish name).¹² Costa

10 The RFA authors adopt a somewhat different definition: “a crisis prevention or resolution mechanism for a defined region or a group of countries sharing similar economic characteristics (for example, BRICS [Brazil, Russia, India, China and South Africa]) and mandated to provide emergency liquidity to its member countries” (Cheng et al. 2018, 5-6).

11 More historical accounts and elaborate description of the RFAs can be found, for example, in IMF (2017b), Cheng et al. (2018) and Miyoshi et al. (2013).

12 See Haggard (2013), Perry (2013), Gabel (2017) and Kring and Grimes (2019).

Table 1: RFAs and Their Relationship to the IMF

Name	Eligible Members	Purpose	Size	Nature of Link to IMF
EU Macro-Financial Assistance Facility	EU candidate, neighbouring and third countries	To provide medium- and long-term financial assistance to address balance-of-payments difficulties	€2.0 billion ^a	Formally linked
EU Balance of Payments Facility^b	EU members that have not adopted the euro	To provide medium-term financial assistance	€50 billion	Not formally linked to IMF programs but linked as a matter of practice in recent cases; members obliged to consult European Union before approaching IMF
European Financial Stabilisation Mechanism	All EU members	To address severe disturbances beyond members' control	€60 billion	Activated "in the context of a joint EU/IMF support," but also reviewed for consistency with EU rules; linked as a matter of Council policy
European Stability Mechanism	Members of the euro area	To mobilize funding and provide stability support under strict conditionality; if indispensable to safeguard the stability of the euro area as a whole and of its member states	€500 billion ^c	Technical and financial IMF participation to be sought "whenever possible"; while not legally necessary, linked as a matter of Council policy
Chiang Mai Initiative Multilateralization	10 member states of ASEAN plus China, Japan and South Korea	To address balance-of-payments and short-term liquidity difficulties; supplement existing international financial arrangements	\$240 billion	Beyond 30 percent of a country's allotment, disbursements are formally linked to an IMF program
Arab Monetary Fund	22 Arab countries in the Middle East and North Africa	Among other things, to correct payments disequilibria, and to foster currency stability through short- and medium-term credit facilities	\$4.8 billion	Ordinary loans are usually accompanied by an IMF program; other types of assistance not necessarily linked

Name	Eligible Members	Purpose	Size	Nature of Link to IMF
Latin American Reserve Fund^d	Bolivia, Colombia, Costa Rica, Ecuador, Paraguay, Peru, Uruguay and Venezuela	To support members' balance of payments with credits and guarantees; to improve the conditions of international reserve investments	\$4.7 billion	Not formally linked, but often linked de facto through overlapping programs
North American Framework Agreement	Canada, Mexico, and the United States	To provide short-term support through Treasury and Fed 90-day swaps, renewable up to one year	\$14 billion	US Treasury requires letter from IMF managing director
Contingent Reserve Arrangement	Brazil, Russia, India, China and South Africa	To meet short-term balance-of-payments pressures through liquidity and precautionary instruments	\$100 billion	Beyond 30 percent of allotment, linked to an IMF program
Eurasian Fund for Stabilization and Development^e	Armenia, Belarus, Kazakhstan, Kyrgyzstan, Russia and Tajikistan	To provide financial credits, loans and grants to ensure long-run economic stability of members and foster economic integration	\$8.5 billion	Not formally linked, but sometimes de facto
SAARC Swap Arrangement^f	Afghanistan, Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan and Sri Lanka	To address short-term liquidity or balance-of-payments difficulties; to supplement international financing arrangements	\$2.0 billion	No explicit role for the IMF

Sources: IMF (2017g); institutional websites; author's assessment.

Notes:

- a. Annual lending capacity.
- b. Formerly referred to as Medium-Term Financial Assistance, which was created in 1988.
- c. Total lending capacity; the ESM is capitalized at €704.8 billion.
- d. Transformed from the Andean Reserve Fund into FLAR in 1989.
- e. Previously known as the Eurasian Economic Community Anti-Crisis Fund, established in 2009.
- f. SAARC is South Asian Association for Regional Cooperation.

Table 2: Latin American Reserve Fund – Resources and Access (US\$ millions unless otherwise noted)

Country	Subscribed Capital ^a		Paid-in Capital ^a		Access Limit ^b		Max. Access	Max. Access (% of IMF Quota) ^c	Max. Access (% of GDP) ^d	Max. Access (% of Short-term Liabilities) ^d
	US\$ millions	Share (%)	US\$ millions	Share (%)	Liquidity Facility	Balance of Payments Facility				
Bolivia	328	8.3	245	8.33	270	637	637	188	1.88	134
Colombia	656	16.7	491	16.69	491	1,228	1,228	43	0.44	11
Costa Rica	656	16.7	488	16.59	488	1220	1220	234	2.14	48
Ecuador	328	8.3	245	8.33	270	637	637	65	0.65	68
Paraguay	328	8.3	245	8.33	245	613	613	216	2.23	13
Peru	656	16.7	491	16.69	491	1228	1,228	65	0.64	16
Uruguay	328	8.3	246	8.36	246	615	615	102	1.17	n/a
Venezuela	656	16.7	491	16.69	491	1,228	1,228	23	0.25	4
Total	3,936	100	2,942	100						

Data sources:

^a <http://flar.net/estructura-de-capital/>

^b <http://flar.net/lineas-de-credito/>

^c Converting quotas to US\$ at 1.409 US\$ per Special Drawing Right (SDR).

^d World Bank, World Development Indicators, 2018.

Rica joined FLAR in 2000, Uruguay in 2009 and Paraguay in 2014. Table 2 provides an overview of FLAR's capital structure, facilities and access.

FLAR's total subscribed capital is \$3.94 billion, of which \$2.94 billion was paid in as of February 2018.¹³ The institution can also borrow on the capital markets by issuing bonds, although it has done so on only two occasions. FLAR has lent both three-year balance-of-payments loans and liquidity operations of one year or less — amounting to \$4.9 billion and \$4.4 billion in total, respectively, during 1978–2013.¹⁴ Over the life of the institution, Ecuador has been the greatest user, followed by Peru, Colombia and Bolivia.¹⁵

FLAR and its Latin American advocates take pride in several distinctive aspects of its operations.

First, while the amount of lending has been small in the grand scheme of Latin American finance, its financing was greater than that of the IMF for the Andean countries during the 1980s, the decade of greatest activity for the facility.¹⁶ Second, in contrast to the RFAs in Europe and East Asia, FLAR maintains *no formal link* to the IMF and does not apply explicit policy conditionality to financial support akin to the Fund's. Nor has it ever denied a (formal) loan request. In its lending policies, the facility nonetheless appears to have been relatively orthodox,¹⁷ has been effectively accorded preferential status as a creditor by its members¹⁸ and maintains a credit rating that is higher than the sovereign bonds of its members, situating it well for mediating funds between the financial markets and its members. Third, led by central bankers, FLAR's governance and decision

13 All dollar figures in this report are listed in US dollars.

14 Since that period, FLAR has extended credits to Ecuador in 2014 (\$617.6 million) and 2018 (\$368.8 million), Venezuela in 2016 (\$482.5 million) and Costa Rica in 2018 (\$1 billion). The grand total for the life of FLAR is thus about \$11.8 billion.

15 See also Rosero (2014) on lending history.

16 See Titelman (2006) and Ocampo and Titelman (2012).

17 Parameters are established in the Constitutive Agreement and Bylaws, FLAR (2013).

18 On the case of Peru in the 1980s, see Boughton (2001, 783–86) and Eichengreen, Lombardi and Malkin (2018).

making has, at least until 2016, been relatively collegial and uncontroversial. Owing to these features, observers who search for institutional arrangements for addressing financial crises that exclude the IMF celebrate FLAR's example.¹⁹

These distinctive features of FLAR must be placed in a broader context, however. It would be misleading to say that FLAR has no requirement to adjust policies at all, in two respects. First, a country's application for balance-of-payments support must include a report on the measures that it has or will adopt to "correct or attenuate the balance of payments lack of equilibrium" (FLAR 2013, 53). The report addresses monetary and fiscal policy and the financial sector, among other things, and serves as the basis for board review and the decision to grant support. One important difference with IMF conditionality remains: the economic plan is drawn up, and consequently "owned," by the borrower.

Second, FLAR lending has, historically, often taken place in proximity in time to IMF programs and arrangements extended by the Exchange Stabilization Fund (ESF) of the US Treasury. Figure 1 displays the pattern of lending among these three creditors to the countries in FLAR since 1978. In some cases, FLAR, like the ESF, extended bridge financing to IMF credits. In other cases, FLAR's repayment prospects were strengthened by the adjustment requirements imposed by the IMF program. In both cases, FLAR's operations were economically and financially intertwined with those of the global multilateral institution. Not all of FLAR's credits coincide with IMF programs, and the overlap seems to have been diminishing in recent years; however, it is again evident in the present case of Ecuador.

Otherwise, FLAR's relationship with the IMF, while cordial, is distant relative to the Fund's relationship with the other two RFAs considered here. The Bogotá- and Washington-based institutions cooperate on capacity building and technical assistance to members. But possibilities for the exchange of information are restricted by the absence, at least for the moment, of a memorandum of understanding (MOU) between them, such as exists between FLAR and the ESM and the ASEAN+3 Macroeconomic Research Office (AMRO). Perhaps the most important

element of explicit institutional cooperation is an agreement that capital contributions to FLAR can be counted as members' international reserves under the definition of the IMF.

Despite its good repayment history, FLAR faces a number of challenges at the moment. First, because its institutional budget is constrained, with operating expenses at about \$8 million per year (FLAR 2017, 8), the staff of the executive president, headquartered in Bogotá, is stretched thin. Its capacity to conduct surveillance and assess country policies, let alone design country programs should it be given the mandate to do so, is similarly restricted. Second, the consensus-oriented governance of the institution is under strain, principally because of cleavages that have emerged in recent years among the membership.

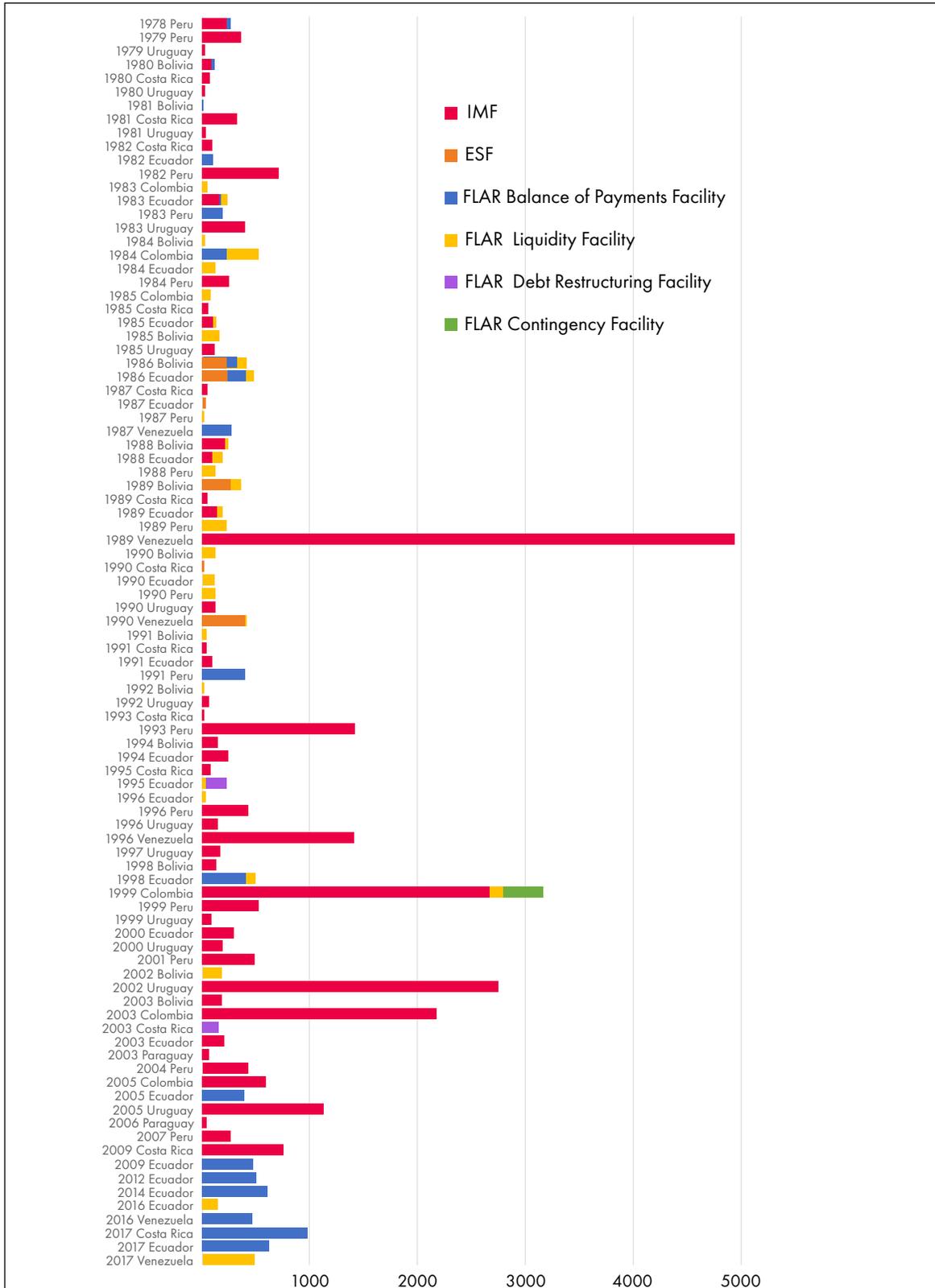
Stress on FLAR governance is particularly evident in its disbursement to Venezuela — undertaken without a parallel program with the IMF — which was first announced in July 2016. At that moment, the Venezuelan economy had already entered its downward spiral, the country's humanitarian catastrophe was beginning, and its central bank was desperate for foreign exchange. Objectively, prospects for Venezuela were questionable, but the board of directors approved a disbursement nonetheless. After FLAR issued a loan and later replaced it, the ultimate outcome of this contentious process was a credit of \$482.5 million, an amount that then exactly matched Venezuela's paid-in capital. The size of the credit suggests that several members of the board, all central bank governors, took the view that access up to the amount of their capital contributions should be relatively unencumbered. Most of this credit remains outstanding but was serviced at least through 2018 even while Venezuela was renegotiating its terms with other creditors and grappling with US sanctions. Standard and Poor's (S&P) and Moody's reaffirmed the institution's favourable credit rating in March and May 2019, respectively, albeit with a negative outlook by S&P.²⁰ Uncertainty about the future of this loan nonetheless poses a continuing challenge to FLAR.

FLAR also has outstanding credits to Costa Rica and Ecuador, with those to Ecuador raising questions about the repetitive nature of that

¹⁹ For discussion of bypasses to the IMF, see Medhora (2017). See also Perry (2013) and Grabel (2017, 152–57).

²⁰ See S&P (2018). Moody's statement is available at www.moody.com/research/Moodys-affirms-FLARs-Aa2-rating-maintains-stable-outlook-PR_399203.

Figure 1: Loans to FLAR Members by the IMF, ESF and FLAR, 1978–2017 (US\$ millions)



Data sources: IMF; FLAR; Henning (1999).

country's drawings and whether its regional neighbours should insist on more sustained adjustment in order to wean Quito off of its reliance on the institution. These loans could give pause to members, existing and prospective, when considering injecting additional resources to FLAR.

Finally, and importantly, FLAR remains small in size financially, which places restrictions on the scope of FLAR's financial support for members. Therefore, while FLAR can provide liquidity to members in modest quantities, countries that encounter more severe crises that require larger volumes of financing and deeper adjustment must turn to the IMF, the current program with Ecuador again being a case in point (IMF 2019a).

FLAR's comparatively small size is not due to the absence of international reserves in the region that could be mobilized. As of mid-2018, foreign exchange reserves of Latin American countries totalled about \$844 billion, of which Brazil held about \$380 billion and Mexico \$178 billion. But these large reserve holders are not members of FLAR (which collectively held about \$159 billion in reserves).

Expanding the membership to the large countries of the region is, and should be, a strategic objective of the institution. The case for doing so rests on catching up with the deepening of economic and social interdependence among countries in the region. Not only do economic crises propagate from one country to the next, but regional neighbours are also subjected to migration shocks by humanitarian catastrophes in Venezuela and Central America. An expanded FLAR could play a greater constructive role in the context of other forms of regional solidarity.²¹

If it were further developed, FLAR could serve as a regional partner for the IMF. The Fund could benefit from an enhanced FLAR in the same way that it can, in principle, from the development of other RFAs: incorporation of local knowledge, expanded and more frequent surveillance, bridge financing during program negotiations, financial contributions to loan packages and softening of IMF stigma.

Scaling up FLAR to perform such a role would require inducting Brazil, Mexico, Chile or Argentina, or some combination of this group. In order to elicit the interest of these countries, however, the current membership would have to take two measures that would transform the character of the institution. First, it would have to open the governance provisions for the introduction of weighted voting. Large prospective members are unlikely to accept the one-country, one-vote rule that formally applies to decisions on loans as well as amendments to the founding articles. Second, it would have to create a mechanism to assure these likely creditors that borrowers will undertake adjustment when that is necessary to restore external balance and access financial markets. Building a capacity to design policy conditionality into lending programs would be one route but would require a considerable investment in staff resources and budget, not to mention intrusion into national policy making. The faster, less expensive route would be to simply link to IMF programs. Most of the current membership would probably prefer the first route to the second, but no RFA outside of Europe has yet come close to successfully pursuing it.

It is not clear that the divergent preferences of small and large countries can be bridged. Existing members have shown little interest in governance reform or an IMF link. Large prospective members could not rely on the institution to assist them in a crisis, because they would be too big for FLAR to rescue. Their interest in joining would stem from spillover effects from instability within regional neighbours, although none of the four have been particularly enthusiastic sponsors of regional projects in the past. A cleavage within the region between orthodox and heterodox governments could perpetuate their reluctance. Nonetheless, by stating the conditions under which FLAR might expand, a course can be charted in the event that political circumstances become more propitious in the future.

East Asia

The countries of the ASEAN+3 group have two decades of experience developing regional financial institutions for East Asia. Shortly after the Asian financial crisis of 1997-1998, they launched the Chiang Mai Initiative. After the global financial crisis of 2008-2009, they scaled up and multilateralized the facility, creating the Chiang Mai

21 Proposals for developing and expanding FLAR include Latin American Shadow Financial Regulatory Committee (2012), Ocampo and Titelman (2012), Agosin (2013), Rosero (2014) and Titelman et al. (2014).

Initiative Multilateralization (CMIM).²² ASEAN+3 also agreed upon an economic surveillance unit, the AMRO, which was established in 2011.

ASEAN+3 Institutions

Table 3 shows the current state of the CMIM and the access limits relative to IMF quotas and short-term external liabilities. As can be seen there, the five original members of ASEAN can, in principle, draw up to \$22.76 billion under the facility. In the case of Indonesia, for example, this access amounts to roughly 3.4 times the country's quota in the IMF, representing about half of its short-term external liabilities. In the case of the Philippines, it amounts to about 7.7 times its IMF quota. (For comparison, Indonesia borrowed \$18 billion from the IMF, World Bank and the Asian Development Bank [ADB] as part of its 1997-1998 rescue package, which included another \$18 billion in a second line of defence that was not disbursed.) However, most of the funds can be accessed only if the borrower also agrees to an IMF program and its conditionality — a provision known as the “IMF link.” The delinked portion of these funds is currently 30 percent of the total, or \$6.8 billion for the large Southeast Asian countries.

In 2014, ASEAN+3 officials introduced a precautionary line into the CMIM, following the development of precautionary facilities by the IMF. Under the CMIM Precautionary Line (PL), members with highly rated policies could qualify in advance for credit up to their access limits to guard against being sideswiped by global financial volatility. This facility was differentiated from regular access, labelled the Stability Facility (SF). The two could not be drawn simultaneously, but a country that had drawn on the PL could convert to a stability drawing if longer-term financing were needed, in which case it would be expected to also take an adjustment program from the IMF.

Because the original Chiang Mai Initiative had been inspired by antipathy toward the IMF after the 1997-1998 crisis, the link to the Fund has been contentious among the membership. The large creditor countries, Japan and China, have adhered to the link, while the Southeast Asian countries

have objected, seeking to roll it back over time to establish a regional rescue vehicle that can operate more independently of the Fund. The requirement that a borrower agree to a program with the IMF discourages its use. But the ASEAN+3 finance ministers and central bank governors have declined to increase the delinked portion beyond 30 percent (ASEAN+3 Finance Ministers and Central Bank Governors 2018).²³ Resistance to increasing the delinked portion, in addition to other issues, has created rifts within the ASEAN+3 group that are unusually deep at the moment. While the development of the CMIM originated in popular rejection of the IMF “stigma,” some creditor-country officials are rethinking the idea of progressively loosening the connection to the Fund.

If East Asia were ever to create a capacity to address financial crises on a fully regional basis, which a number of observers advocate, a robust capacity for surveillance and economic analysis would be essential. ASEAN+3 took a major step forward in this respect when creating AMRO and locating it in Singapore (Chabchitrchaidol, Nakagawa and Nemoto 2018). In February 2016, the group upgraded the unit to a full-fledged public international organization (AMRO 2016a; 2017a). Its management and staff, which numbered about 57 at the end of 2018, are mandated to monitor and assess macroeconomic policies and financial soundness of members, identify vulnerabilities and recommend measures to mitigate risks. Its officials brief the ASEAN+3 deputies and ministerial meetings and, in April 2017, on the twentieth anniversary of the onset of the Asian financial crisis, published their first surveillance report for the region (AMRO 2017b). The organization now publishes a steady stream of country surveillance reports and regional economic outlooks.²⁴ AMRO is also tasked with supporting members in the implementation and further development of the CMIM (AMRO 2016b; 2016c), discussed below.

It is important to note that, owing partly to the link, the CMIM has *never* actually been *activated*. But it would be wrong to conclude that the facility is therefore inconsequential, for several reasons. First, the CMIM serves as a focal point around which finance ministries and central banks in the region confer and develop common strategies

22 On financial arrangements in East Asia, see Grimes (2009; 2018); Katada (2012); Cohen (2012); Miyoshi et al. (2013); Katada and Armijo (2014; 2015); Ciorciari (2011); Kawai (2015); Chang (2016); Henning (2002; 2019); Henning and Katada (2016); Chey (2009); Sterland (2017a; 2017b); Eichengreen, Lombardi and Malkin (2018); Pitakumrongkit (2016); Darvas (2017); Sussangkarn (2011; 2017); Kadogawa et al. (2018); Subacchi (2018); and Truman (2018b).

23 See also ASEAN+3 Finance Ministers and Central Bank Governors (2017) and Khor (2017).

24 Available at <https://amro-asia.org/publications/>.

Table 3: Chiang Mai Initiative Multilateralization – Resources and Access
(US\$ billions unless otherwise noted)

Country		Financial Contribution ^a		Purchasing Multiple	Maximum Swap Amount	Max. Drawing (% of IMF Quota)	Max. Drawing (% of Short-term Liabilities) ^b	De-linked Portion	
		US\$ billions	Share (%)					30%	40%
Plus-3		192	80						
China	China (ex Hong Kong)	68.4	28.5	0.5	34.20	78	4	10.2	13.6
	Hong Kong	8.4	3.5	2.5	6.30	n/a	n/a	1.8	2.5
Japan		76.8	32.0	0.5	38.40	86	n/a	11.5	15.3
Korea		38.4	16.0	1.0	38.40	308	n/a	11.5	15.3
ASEAN		48	20						
Indonesia		9.104	3.793	2.5	22.76	339	54	6.8	9.1
Thailand		9.104	3.793	2.5	22.76	491	43	6.8	9.1
Malaysia		9.104	3.793	2.5	22.76	434	27	6.8	9.1
Singapore		9.104	3.793	2.5	22.76	404	n/a	6.8	9.1
Philippines		9.104	3.793	2.5	22.76	771	157	6.8	9.1
Vietnam		2.00	0.833	5.0	10.0	600	71	3	4
Cambodia		0.24	0.100	5.0	1.20	475	69	0.3	0.4
Myanmar		0.12	0.050	5.0	0.60	80	79	0.1	0.2
Brunei Darussalam		0.06	0.025	5.0	0.30	69	n/a	0.09	0.1
Lao PDR		0.06	0.025	5.0	0.30	196	42	0.09	0.1
Total		240.0	100.00						

Note: Converting quotas to US\$ at US\$1.445 per SDR.

Data sources:

^a AMRO, “Key Points of the CMIM Agreement,” at www.amro-asia.org/key-points-of-the-cmim-agreement/.

^b World Bank, International Debt Statistics, 2016.

for crisis prevention and response. Second, its existence alters the behaviour of other institutions in the system; the IMF has taken pains to appeal to Southeast Asian countries by reviewing conditionality and offering precautionary facilities, among other things. Third, as a matter of principle, disbursements should not be used as the most significant measure of effectiveness; precautionary arrangements are most effective if they sustain market confidence and therefore never have to

be drawn. Finally, these institutions serve as a foundation on which to build, and ASEAN+3 could well activate the CMIM at some point in the future.

Massive unilateral reserve accumulation serves as the backdrop for the political economy of East Asian regionalism. Most of these reserves are held by the “+3” countries — China, Japan and South Korea. But the holdings of Southeast Asian countries are large by the standards of EMDCs, amounting

to roughly \$840 billion. These holdings serve as the first line of defence against financial market volatility, an additional reason why these countries have not resorted to official financing since the global financial crisis. They represent a hedge against the failure of regional or global cooperation, albeit an extraordinarily expensive one.²⁵

The ASEAN+3 institutions face a number of questions and strategic challenges with respect to their relationship to the IMF, their institutional development and the divergent preferences of member states, and the political economy of the region.

Coordination with the IMF

With respect to the relationship with the IMF, the link creates the need to coordinate the operational and policy aspects of co-financing. In order to smooth the machinery for activation, ASEAN+3 and the IMF have jointly conducted “test runs” annually during 2016–2018. Based on a country-specific scenario agreed in advance, the test requires officials to communicate, coordinate and activate the financial accounts through which funds would be disbursed in an actual contingency. They revealed several weaknesses — exchange of information, timing of disbursements and repayments, and policy conditionality — which are being addressed by both sides.

The ability to share information about country conditions, forecasts and programs is closely tied to the legal status of the institutions involved. AMRO is a bona fide public international organization but does not itself provide financing. The CMIM provides finance but is a contract among the 14 parties (ASEAN+3, plus Hong Kong) rather than a formal international organization. This complicated arrangement does not preclude cooperation between the Fund and AMRO on technical assistance, training and joint meetings (AMRO 2017c). But it does complicate the exchange of information on potential programs and, as mentioned above, some member countries caution non-Asians against using AMRO as the conduit for cooperation on matters that ASEAN+3 has not explicitly delegated to it.

The CMIM and the IMF differ with respect to the modalities of disbursements and repayments. At

the time of activation, the CMIM would disburse the full amount of its commitment up front, as would be the case in a BSA. The IMF, however, disburses in tranches according to a schedule that is established in the program to coincide with financing needs and implementation of policy reforms. Disbursements can be suspended if the borrower does not satisfy the Fund during its reviews, which are conducted quarterly. This difference can be treated by phasing CMIM disbursements similarly.

The repayments schedule is more problematic. The issue is which institution is to be repaid first and which is left bearing the outstanding credit risk. The CMIM was originally a short-term liquidity facility based on bilateral central bank swaps and was subsequently organized to mobilize them jointly. After amendments in 2014, the linked portion could be tapped for a term of one year, renewable twice for a total of three years (ASEAN+3 Finance Ministers and Central Bank Governors 2014).²⁶ But the IMF’s Stand-By Arrangement (SBA) would typically be available for drawings for up to three years, with full repayment not being received until 3.25 to 5 years after the last disbursement. Under those arrangements, ASEAN+3 would have been repaid first, leaving the IMF with the residual risk, which was unacceptable to the IMF. So, at their meeting in Manila in May 2018, the finance ministers and central bank governors decided to make it possible to align the term of CMIM credits with those of the IMF for both the standard SF, which would correspond to the SBA, and the PL, which would correspond to the Precautionary and Liquidity Line (PLL) at the Fund (ASEAN+3 Finance Ministers and Central Bank Governors 2018, Annex).²⁷

By its rules, the IMF needs “firm commitments” that the program is funded on a 12-month rolling basis and “good prospects” at the outset that it will be funded for the full duration of the program (IMF 2013a, 44). Given that CMIM-SF credit is initially made available for only one year, the Executive Level Decision Making Body (ELDMB) would have to renew the credit much earlier than ASEAN+3

²⁵ See, in this regard, Lipsy and Lee (2019).

²⁶ The delinked portion has a term of six months, renewable three times, for a total of two years.

²⁷ The changes were discussed at the meeting of the finance and central bank deputies meeting in December 2018 and formalized at the ministerial meeting in May 2019, along with other amendments to the CMIM Agreement. See ASEAN+3 Finance Ministers and Central Bank Governors (2019).

officials had originally envisaged in order to meet this requirement. Failure to do so could bring the entire program to a screeching halt midway, unless other sources of funding could be found. ASEAN+3 finance ministry and central bank officials seem open to considering renewal of swaps at such time that the IMF's financing assurances are satisfied on the 12-month rolling basis for the duration of the program, but whether the problem is fully rectified remains an important operational issue.

The IMF and ASEAN+3 institutions disagree over whether policy conditionality should be joint or simply led by the IMF. ASEAN+3 member states also disagree among themselves on this matter. Some countries, particularly in Southeast Asia, insist that AMRO and the CMIM must develop their own view as a region as to the conditions that should be applied to program lending with the linked portion. Such conditions should, to a significant extent, be the common product of the regional institutions and the Fund working together, they maintain. Other member states argue that the regional institutions are not yet ready for program design, negotiation and implementation. For their part, officials at the IMF stress that there should be a single set of policy conditions and that the Fund should lead on the macroeconomic framework and program design. Fund officials can be expected to resist efforts to develop a common conditionality framework.

Challenges

The member states of ASEAN+3 have not yet agreed on what exactly the relationship between their two regional financial institutions should be. The text of the AMRO agreement declares its purpose to be “to contribute to securing the economic and financial stability of the region through conducting regional economic surveillance and supporting the implementation of the regional financial arrangement” (AMRO 2016a, article 2). And it recognizes the CMIM as a partner with which AMRO will promote regional cooperation “together” (AMRO 2016a, preamble). Moreover, the deputies have identified the development of the Economic Review and Policy Dialogue matrix, operational readiness and “smooth implementation” of the CMIM as AMRO's tasks and they approved the appointment of a deputy director and a staff team with responsibility for these activities (Chabchitrachaidol, Nakagawa and Nemoto 2018).

At the same time, article 3 of the AMRO Agreement defines the institution's function in this regard to be to “support *members* in the implementation of the regional financial arrangement” (AMRO 2016a, article 3, c; emphasis added). This language suggests that the national finance ministries and central banks are expected to mediate AMRO's work as it would be expressed in ELDMB deliberations over CMIM policy and disbursements in a crisis scenario. While AMRO would analyze economic requirements and policy conditions that might be applied to a country's borrowing, and advise the deputies accordingly, the ultimate responsibility for negotiations with a requesting country, building consensus within the ELDMB on activation and coordinating the terms of disbursements with the IMF would ultimately fall on the co-chairs of the deputies' group. Some member states insist on the co-chairs' prerogatives in this regard, resist delegation to AMRO and advise third parties accordingly.

This awkward decision-making arrangement relies heavily on the ability of the co-chairs to understand the substance of programs, balance competing considerations, negotiate with counterparts and communicate clearly. While the IMF managing director must do much of the same, her job is facilitated by supervision of the design of the program, preparation of documents and physical proximity to the executive board. The task of the co-chairs, one from the “+3” and the other from the ASEAN group, is made more difficult by their annual rotation. It is safe to say that no financial facility has been activated by a decision-making mechanism that resembles this one. While the test runs have been designed to iron out glitches in this process, one should be forgiven for being skeptical that this can operate effectively in a crisis. The challenges posed by the separation of the CMIM and AMRO, moreover, would seem to consign ASEAN+3 for the time being to accepting programs that are designed by the IMF.

As far as the delinked portion is concerned, ASEAN+3, the CMIM and AMRO are probably ready to activate should a country come to the group to request assistance. AMRO is developing the conditionality framework that would apply and, as an operational matter, the procedural and legal glitches have probably been cleared. The barriers that remain have to do with uncertainty about the short-term temporary

nature of financial need, creditor risk aversion and political tensions among member states.

Indonesia poses a potential challenge for the region. Its economy remains vulnerable to a global downturn, yet Indonesia is known for popular aversion to the IMF since the 1997-1998 crisis.²⁸ Officials in Jakarta would be likely to opt first for support for budget operations from the World Bank and the ADB, supplemented by BSAs with central banks. Bank Indonesia has had swap agreements in place with the central banks of China and South Korea and, over the course of 2018, renewed or opened new swaps with Japan, Australia and Singapore. The strategy replicates the approach taken by the Indonesian government during the turbulence of 2008-2009.

To enhance the package, Indonesia and its partners in ASEAN+3 could, in principle, activate the *delinked* portion of the CMIM-SF or the CMIM-PL. Such a prospect poses interesting questions about how and whether the CMIM and AMRO could coordinate with multilateral development banks and BSAs. The World Bank and the ADB might be willing participants in such a package but some central banks would likely seek the comfort of a Fund program when activating BSAs.

Next Steps

Fundamentally, the separation of surveillance and analysis in AMRO from the financial resources in the CMIM, and the holding of the CMIM's resources in the separate accounts of the national central banks rather than pooling, reflect the reticence of the 13 member countries to make the collective leap to creating an embryonic Asian Monetary Fund (AMF). There are important reasons for their unwillingness, thus far, to do so, which are discussed below. Yet, further progress toward developing regional institutions can still be made within these constraints.

Creating a full-fledged RFA that mirrors the institutional model of the ESM or the IMF itself would call for three important institutional reforms. First, the member states would agree to combine AMRO and the CMIM into a unified institution, allowing the secretariat to analyze requests for disbursements without national officials serving as intermediaries and to design

programs, negotiate them with borrowers, propose agreements to the ELDMB for approval and represent the combined institution to third parties, including other institutions such as the IMF. Second, ASEAN+3 member states would agree to pool the reserves that back the CMIM into a single account. This could be done either as a quota contribution, as in the case of the IMF, or as a capital contribution, as in the case of the ESM. Either way, financial operations would be greatly simplified, and disbursements would be more certain. Finally, the agreement underpinning the new, combined institution should be made public. This is not the case with the CMIM Agreement,²⁹ and disclosure would be essential for an institution that lends large sums on programs of its own design, whether they are lenient or austere.

While these steps would be necessary to create the equivalent of an AMF, it is not clear that ASEAN+3 will take them. A divergence of preferences among member states presents a formidable barrier to taking this institutional path. The rivalry between China and Japan for influence within the region is well known.³⁰ There is also tension between each of them and South Korea, between the +3 as a group and the 10 Southeast Asian countries, as well as among the Southeast Asian countries themselves. A common interest in the 13 states (plus Hong Kong) in avoiding financial turbulence in the region has underpinned the ASEAN+3 institutions so far. Regional cooperation survived, and was even strengthened, during the global financial crisis. Conflict with the Trump administration could strengthen incentives to overcome their differences. But whether ASEAN+3 cooperation survives a financial shock that comes from within the region, rather than outside, or a crisis in the area of foreign policy and security remains to be seen.

In light of preference divergence, East Asian countries have avoided putting all of their cooperation "eggs" in the regional basket. Seeking financial options that cannot be effectively vetoed by neighbours in the region, they have built up precautionary reserves unilaterally and

²⁹ One reason is that the agreement embodies the institutional and governance provisions of the CMIM as well as the more market-sensitive terms of CMIM disbursements. Publication of the agreement would disclose both. Rewriting the agreements by placing the governance provisions in one document and the transaction-specific provisions in program documents would enable disclosure of the former without publicizing the latter.

³⁰ Benjamin J. Cohen (2012), among others, emphasizes this point.

²⁸ See also Sterland (2017a).

developed potentially rivalrous networks of BSAs. And, of course, they maintain the link to the IMF. States in the region are instead creating a more complicated patchwork of institutions.

Europe

Europe is, of course, the largest and most developed of all the world's regions. Debates about the role of regional institutions and their relationships with global multilateral ones are largely inspired by this region's example. The management of the euro-crisis programs in the troika has received particular attention as a set of cases of both cooperation and conflict among international financial institutions.³¹ This experience has inspired reconsideration both in Europe and at the IMF of their own policies and the arrangements and conventions by which they relate to one another.

This subsection focuses mainly on the ESM, enhancements to which are in the process of being introduced. It is important to remember that the ESM's evolution takes place within a European institutional ecosystem that includes the European Commission, the ECB and the Single Supervisory Mechanism (SSM), and a corpus of law, regulations and procedures relating to fiscal policies, sovereign debt and banking union. Legally, the ESM sits outside the EU treaty framework and the Community method³² — although it is nonetheless guided by Council bodies and, in particular, the Eurogroup — and reforms to the ESM are subject to ratification by some of the national parliaments in the euro area. Changes to European institutions will affect not only how crises are prosecuted in the euro area but also the global safety net more broadly.

European Facilities and the Troika

Europe's Economic and Monetary Union (EMU) has a cluster of institutions that can become involved when a country requests financial assistance in a crisis. Some of the financial facilities predate the crisis and some were created and expanded during the crisis: the balance-of-payments facility, the European Financial Stabilisation Mechanism

(EFSM), the European Financial Stability Facility (EFSF) and the ESM. The largest of these, the ESM, was created in 2012 by the euro-area member states via an intergovernmental treaty and endowed with total capital of €704.8 billion, of which €80.5 billion is paid in, giving it a lending capacity of €500 billion (see Table 4).

Note four features of the ESM that relate to its cooperation in the context of the global safety net. First, the stated purpose of the ESM is to provide “stability support under strict conditionality...if indispensable to safeguard the financial stability of the euro area as a whole and of its Member States” (European Council 2012, article 3). Second, recital 8 of its treaty states: “The ESM will cooperate very closely with the International Monetary Fund (‘IMF’) in providing stability support. The active participation of the IMF will be sought, both at technical and financial level. A euro area Member State requesting financial assistance from the ESM is expected to address, wherever possible, a similar request to the IMF” (ibid.).

The ESM is also expected to conduct its DSA together with the IMF, “whenever appropriate and possible” (ibid., article 13, paragraph 1[b]). Third, the ESM can raise funds on the capital markets and has a debt management office to handle bond issuance. Finally, it also has a broad set of lending instruments and in some respects, in principle, more flexibility in lending arrangements than the IMF.

These institutions prosecuted the euro crisis along with the IMF in most, but not all, instances of financial programs.³³ In doing so, however, they argued publicly over some matters that were important to the design of programs, including primacy of the Stability and Growth Pact (SGP) fiscal targets, banking union issues, monetary policy, the Emergency Liquidity Assistance, the involvement of the newly created SSM and the IMF's interest in structural issues such as labour markets and wages. Most famously, European creditor countries were chastened by the IMF's advocacy of even more favourable easing of the terms of official debt to Greece during the third program, arguing that the country's debt was sustainable in the long term with only modest relief. These disagreements,

31 See, for example, Pisani-Ferry, Sapir and Wolff (2013); Leibold (2013); European Parliament (2014); IMF (2015b); IEO (2016); Kincaid (2016); Véron (2016); Blustein (2016); Lundsager (2017); and Henning (2017). See also Tumpel-Gugerell (2017).

32 That is, outside the regular process by which the Commission initiates and the Council and European Parliament approve legislation.

33 The label “the institutions” was substituted for “the troika” as the number of institutions in the arrangement grew beyond the original three, the IMF, the European Commission and the ECB, with inclusion of the ESM.

Table 4: ESM Shareholder Contributions and Ratings

Member State	Credit Rating (S&P/ Moody's/Fitch)	ESM Contribution Key (%)	Capital Subscription (€ billion)	Paid-in Capital (€ billion)
Austria	(AA+/Aa1/AA+)	2.7644	19.48	2.23
Belgium	(AA/Aa3/AA-)	3.4534	24.34	2.78
Cyprus	(BB+/Ba3/BB+)	0.1949	1.37	0.16
Estonia	(AA-/A1/A+)	0.1847	1.30	0.15
Finland	(AA+/Aa1/AA+)	1.7852	12.58	1.44
France	(AA/Aa2/AA)	20.2471	142.70	16.31
Germany	(AAA/Aaa/AAA)	26.9616	190.02	21.72
Greece	(B+/B3/B)	2.7975	19.72	2.25
Ireland	(A+/A2/A+)	1.5814	11.15	1.27
Italy	(BBB-/Baa2/BBB)	17.7917	125.40	14.33
Latvia	(A-/A3/A-)	0.2746	1.935	0.22
Lithuania	(A/A3/A-)	0.4063	2.86	0.33
Luxembourg	(AAA/Aaa/AAA)	0.2487	1.75	0.20
Malta	(A-/A3/A+)	0.0726	0.51	0.06
Netherlands	(AAA/Aaa/AAA)	5.6781	40.02	4.57
Portugal	(BBB-/Ba1/BBB)	2.4921	17.56	2.01
Slovakia	(A+/A2/A+)	0.8184	5.77	0.66
Slovenia	(A+/Baa1/A-)	0.4247	2.99	0.34
Spain	(A-/Baa1/A-)	11.8227	83.33	9.52
Total		100%	704.8	80.55

Source: ESM, EFSF ESM New Investor Presentation, July 2018.

along with the fundamental problem of securing greater stability for the euro area, motivated revival of proposals for creating an EMF (Gros and Mayer 2010; Schäuble 2010; Bénassy-Quéré et al. 2018; Franco-German Economist Group 2017; European Commission 2017a).

Building Up the ESM

During 2017, political developments opened opportunities for deepening institutional reform of the euro area and the European Union. The member states launched discussion of changes in the areas of the EU budget, by advancing proposals for a euro-area budget and a new fiscal instrument to foster convergence, as well as of the banking union and ESM. The European Council agreed in

June 2019 to enhancements of the ESM subject to further specification of a set of related documents, setting December as the target for completion of the package, at which point the revised ESM treaty would be referred to member states for ratification. The package falls short of creating the regional “monetary fund” as early proposals envisioned,³⁴ but would, if enacted, nonetheless substantially enhance the authority of the institution and realign its relationship with its peers.

³⁴ See European Commission (2017a). The scope more closely follows the Meseberg Declaration issued by the French and German governments on June 19, 2018; see www.diplomatie.gouv.fr/en/country-files/germany/events/article/europe-franco-german-declaration-19-06-18.

Once ratified, the enhancements to the ESM would be several.³⁵ First, the ESM would be given greater authority to conduct economic surveillance of member states, in particular with respect to the sources of vulnerability to crises, in cooperation with the Commission. Second, and perhaps most importantly, the ESM would become the backstop for the Single Resolution Fund (SRF) by the end of a transition period, January 2024 at the latest. The decision-making mechanism for activation of the backstop was especially contentious. Third, the terms on which the precautionary facilities of the ESM — the Precautionary Conditioned Credit Line and the Enhanced Conditions Credit Line, which have never been deployed — could be used by “innocent bystanders” whose fundamentals are sound would be clarified. Fourth, the ESM would have an explicit mandate in debt restructuring as a convener of creditors, a forum for their coordination and a contributor to sustainability analysis. Member states commit to introduce single-limb aggregation collective action clauses (CACs) into sovereign bond contracts as of 2022, which would facilitate such restructuring when necessary.³⁶ Finally, the Luxembourg-based institution would be charged more explicitly with designing, negotiating and supervising programs, again in cooperation with the Commission.³⁷

Given the scope of these changes, the revisions to the treaty broaden the stated purpose of the ESM beyond simply providing assistance “under strict conditionality” if necessary to preserve stability of the “euro area as a whole.” They would also permit lending on the basis of lighter, *ex ante* qualification in the case of precautionary facilities, financing through the SRF backstop even when it is not necessarily clear that the whole of the euro area is threatened, as well as broader surveillance on the part of the ESM.³⁸

As far as the legal instrument is concerned, member states decided *not* to introduce these changes via amendments to the European treaties (as the European Commission proposed). Instead, they amended the Treaty Establishing

the European Stability Mechanism, leaving that treaty outside the legal framework of the European Union. The ESM thus remains an intergovernmental institution formally outside the Community method. Nor have member states, for the time being, altered the unanimity rule in the ESM decisions on financial assistance.

Changes of this magnitude inevitably impinge on the mandate and sensitivities of the other institutions in Europe and the IMF. The ECB objected to renaming the ESM, advocated improving its precautionary facilities and underscored the importance of disbursements to the SRF being quick and automatic, subject to the approval of only the boards of the institutions, not member-state legislatures.³⁹ The European Commission raised objections to the infringement of its responsibilities under the treaties for the SGP, Macroeconomic Imbalances Procedure, and the European Semester more broadly, among a number of other things. The Commission also wanted to retain responsibility for signing the MOU with countries receiving assistance and carrying out program analysis, including DSA. A number of northern creditors, principally Germany, wish to enhance the authorities of the ESM, while some of the smaller countries and southern members tend to side with the Commission in these disputes. To define their division of labour, the Commission and ESM struck an interinstitutional MOU of their own in April 2018 and elaborated it in November 2018.⁴⁰ The two institutions expect to revise the MOU once the proposed changes to the ESM treaty take effect.

Even assuming agreement on the full ESM package in December 2019, it remains unclear when political circumstances among member states will permit ratification of the revised treaty. But if adoption proves not to be possible in the near term, this agenda represents the next feasible set of reforms once politics become more propitious at some point in the future.

One might hope for a more ambitious agenda for the monetary union, one that would truly

35 See Eurogroup (2019); see also Regling (2018).

36 On this proposal see, for example, Sobel (2018a) and (2018b).

37 See, for example, the press conferences after meetings of the Eurogroup on November 5 and 19, and December 4, 2018, at <https://video.consilium.europa.eu/en/webcast/985f7045-2944-4443-9c19-8cb4614bf817>.

38 Eurogroup (2019, article 3).

39 See ECB (2018). The ECB also called for clarification of its role in programs, especially in light of the broadening of its mandate to financial supervision with the creation of the SSM after the drafting and adoption of the ESM treaty.

40 See “Memorandum of Understanding on the Working Relations between the European Commission and the European Stability Mechanism,” www.esm.europa.eu/sites/default/files/2018_04_27_mou_ec_esm.pdf. European Commission and ESM (2018) provides an update. See also Howarth and Spendzharova (2019).

“complete” its institutional architecture with, for example, all of the elements of a banking union and genuine fiscal solidarity and risk sharing.⁴¹ But the next crises will arrive long before such measures can be taken. Europe will face the next crises with the institutions it has, or at best the institutions as enhanced by the package presently being finalized in the Eurogroup and Council. It will thus be under this set of institutional arrangements that architects of future financial rescues will avoid, minimize or resolve conflicts such as those that dogged the euro-crisis programs.

Union-wide Policy Assurances

One of the fundamental questions that *has* been confronted, although perhaps not fully resolved, is the role of euro-area-wide policies and institutions in the context of a country program. This problem emerged from the IMF’s standpoint in stark form during the troika programs in the euro crisis. Ireland, Portugal and Greece, for example, made commitments to the Fund through letters of intent as part of their programs. But euro-wide policies — such as the fiscal rules, financial and banking regulation, and monetary policy — remained outside the scope of conditionality, even though in several cases they were *critical* to the success of the program. For example, the ECB raised interest rates twice in 2011, which affected general funding conditions in the euro area and the ability of members to reach their program benchmarks. The criticality of monetary policy, in particular, prompted calls in some quarters to put the ECB “on the other side of the table” in program negotiations — that is, to ask it to accept clear and binding policy commitments. The problem became particularly acute in the case of large countries, whose crises required euro-wide solutions, and is one reason why the IMF did not contribute financing to the 2012 program for the Spanish banking system. The Fund’s evaluation of euro-area programs (IMF 2015a) and the IEO study (2016) prompted the Fund to examine the problem of lending into currency unions generally.⁴²

After extensive consultation with the Europeans, as well as the authorities of the currency unions

in Africa and the Eastern Caribbean, the Fund staff adopted a delicate compromise. It would not recommend that commitments or restrictions on the policies of currency unions be incorporated into program conditions, but instead sought to codify and formalize recent practices about providing assurances on union-wide policies. Borrowing members’ own policy instruments would be expected to shoulder the brunt of the adjustment burden; only when national measures were insufficient would assurances be sought from union-level institutions. Union policies must be critical to the success of the program in these cases; assurances with respect to them should be clear, specific, monitorable and time bound; and they must be consistent with institutions’ mandates and legal frameworks.⁴³

Policy assurances would be provided in a letter to the managing director that would accompany the program documents as they were considered and approved by the executive board. Particular attention was given to the problem of providing policy assurances without either appearing to compromise the independence of the currency union’s central bank or telegraphing changes in policy to markets or possibly to legislatures prematurely. So, by way of exception, some such commitments could be provided in writing confidentially and, in rare cases, orally to the managing director, with reporting on a periodic, confidential basis to the board.

Both the Europeans and the executive board seemed reasonably content with this compromise, adopted in a “spirit of consensus,” although a number of executive directors would have preferred a harder option. But the workability of the compromise in a severe crisis for a large country in which union-level policy is inextricably intertwined with the success of the program remains to be tested.

One could easily imagine a scenario in which a country approaches the ECB to activate the Outright Monetary Transactions (OMT) program, and the ECB insists that the country accept a program from the ESM and the IMF together. ECB President Mario Draghi’s announcement of the details of OMT in September 2012 specified that such a country would be expected to go to

41 Recent contributions include Claeys (2017), Bénassy-Quéré et al. (2018); and Kincaid (2019).

42 Various external studies include Blustein (2016); Brunnermeier, James and Landau (2016); Henning (2017); Mody (2018); Lütz, Hilgersand and Schneider (2019); Moschella (forthcoming).

43 See Hagan and Bredenkamp (2018); IMF (2018). See, in the latter (pages 1–4), the summing up of the executive board meeting on March 16, 2018, which discussed the staff paper.

the IMF. The ECB could reconsider the link, but has not to date publicly qualified or rescinded this requirement.⁴⁴ The Fund could well perceive the conduct of not only monetary policy but also banking regulation, private-sector bail-in during bank rescues and the administration of EU fiscal rules to be critical to the program, in which case they could be subject to assurances. Whether the non-European countries among the membership accept the firmness of the assurances and how they are communicated to the board could, given the stakes involved, determine the involvement of the Fund.

Future of the IMF in the Euro Area

During the most intense standoff over the third Greek program, several key creditors began to rethink their preference for involving the IMF in rescue programs. French President Emmanuel Macron said in September 2017 that the IMF had “no place” in EU affairs and that Europe should “head toward a European Monetary Fund” (Khan 2017). The European Commission issued its formal proposal for such an institution and the Euro Summit placed the subject on its agenda shortly thereafter.⁴⁵ Meanwhile, the German coalition agreement between Chancellor Angela Merkel’s Christian Democrats and the Social Democrats aimed to create an EMF.⁴⁶ The chancellor herself, in discussing proposals by President Macron, said, “We also want to become independent from the International Monetary Fund. The European Stability Mechanism (ESM), which we created in the crisis, is to become a European Monetary Fund, an EMF — with instruments like those of the IMF” (Gutschker and Lohse 2018).

For its part, the Trump administration is also raising serious questions about the participation of the IMF in any further European contingencies. “All IMF members have a right to the Fund’s emergency financing,” a spokesperson for the US Treasury said in October 2018. “However, the European members have now established their own emergency financing capability at the EU and eurozone level and have announced that they will no longer seek IMF financing in the

event of a crisis” (Fleming and Politi 2018). As a consequence, this Treasury official argued, the financial resources of the IMF were sufficient for the time being, but will have to be evaluated in the future, in light of the expiration of the bilateral borrowing agreements and US participation in the New Arrangements to Borrow (NAB).

The assertion that they would “no longer seek IMF financing” was a surprise to European officials; none had announced that they would waive their rights to draw from the Fund in a crisis. Chancellor Merkel’s statement certainly could not be construed this way, particularly since the institutional reforms she advocated have not been agreed, let alone enacted. But the statement, if we were to take it seriously, suggests the current leadership of the US Treasury could oppose drawings for euro-area member states.

The language of the revised ESM treaty does not alter the role of the IMF. There remains a formal presumption that the IMF’s involvement will be sought and an acknowledgement that its participation is not strictly necessary, in order to provide for situations in which the Fund and the European institutions cannot agree on basic parameters of a program. On the one hand, this formulation leaves the door open to repeating cooperation similar to most of the cases that arose in the euro crisis, Ireland, Portugal and Cyprus. On the other hand, European and IMF officials are probably less likely to come to agreement on programs for highly indebted countries in the absence of debt restructuring, which could be problematic for any future contingency involving Greece or Italy, for example.

Fundamentally, creating a genuine, full-fledged EMF would be desirable for both Europe and the rest of the world.⁴⁷ It would help to complete the unfinished architecture of the euro area and could relieve the rest of the world of providing rescues in crises to which the incompleteness of the union has contributed. Any decision to forgo drawings on the IMF would have important long-term consequences for these institutions. Among other things, it would greatly strengthen the case for consolidating member states’ position in the IMF into a single European

44 See ECB (2012). The relevant sentence reads: “The involvement of the IMF shall also be sought for the design of the country-specific conditionality and the monitoring of such a programme.”

45 See European Commission (2017b).

46 See www.tagesschau.de/inland/ergebnis-sondierungen-101.pdf, page 5.

47 For a recent analysis, see Kincaid (2019).

membership, thereby facilitating increases in the quota shares of faster-growing EMDCs.⁴⁸

But euro-area member states are not, for the moment, anywhere close to taking these steps and are likely to continue to involve the IMF in one fashion or another in the next set of programs, whenever such a crisis might come. Putting aside for the moment the question of whether non-European countries would agree to “supply” the IMF, Europe’s “demand” for the Fund’s involvement is likely to endure. Desire on the part of creditor states to curb “drift” on the part of the European Commission remains a principal reason for involving the Fund, ameliorated only in part by the appointment of a German as Commission president. Germany can be expected to rely more heavily on the ESM, in which creditor states might place greater faith, in the future. But divergent preferences among member states lay beneath creditor distrust of institutions in Europe and this divergence will persist, if not grow. Moreover, the ESM will continue to make decisions on financial assistance by unanimity, under which one creditor state or another is likely to continue to insist on the IMF’s involvement.

Modest as they might be, the present changes to the ESM treaty and the package of which they are a part should be ratified and enacted. The rest of the world should welcome them as a constructive contribution to European and global governance but should also prod the euro area toward further institutional deepening to place the monetary union on a permanently stable foundation.

The Evolving IMF

The IMF has not been standing still as the RFAs have been evolving over the last two decades. It has instead undertaken numerous reforms to its lending instruments and guidelines on conditionality — including the introduction of the precautionary facilities — and has recently reviewed its lending framework, relationships with RFAs and its “tool kit” of financial facilities. Discontent with the IMF’s participation in the troika during the sovereign debt crisis of the euro

area was the proximate motive for these reviews (IEO 2016). But IMF officials were also motivated by recognition that they are likely to be called upon to cooperate with financial institutions in other regions and new lending instruments have been designed specifically to be palatable to countries in East Asia, Latin America and elsewhere.

IMF staff wrote and the executive board discussed a series of papers as part of this effort. It began with the *ex post* evaluation of the first program for Greece, which was released by the Fund in 2013 (IMF 2013b), much to the chagrin of a number of European officials. The effort continued with papers on the Fund’s lending framework (IMF 2014; 2015a; 2016a), examined in the section “Dangers and Remedies”; its approach to crises generally (IMF 2015b); the first half of the euro crisis (IEO 2016); the GFSN (IMF 2017a); the tool kit (IMF 2017b; 2017c; 2017d; 2017e); and collaboration with the RFAs (IMF 2017f; 2017g; 2017h). The Fund also conducted an extended review of its lending to countries in currency unions, which it published in 2018, as discussed in the previous section (IMF 2018).

The IMF was guided by two institutional imperatives in reviewing its relationship with the RFAs.⁴⁹ First, while it welcomes the development of RFAs in general, the Fund wishes to preempt competition over the design of programs. Competition between the two creditors would threaten to weaken the conditions attached to lending. Prospective borrowers might welcome this, of course, but such competition is likely to undermine the effectiveness of programs. Conditionality is difficult enough to establish on technical grounds; adding competitive considerations could be severely damaging. Second, the IMF wishes to avoid the nightmare scenario in which a region misdiagnoses a crisis, intervenes poorly and turns to the Fund belatedly.

The upshot of the Fund’s review of collaboration with the RFAs, as far as how institutions would cooperate in a crisis contingency for a country with dual membership is concerned, was at least four-fold.

First, the IMF executive board approved the introduction of a new tool, the Policy Coordination

48 See, among others, Henning (1997; 2006; 2011).

49 On the IMF’s relationship to regional arrangements, see, in addition to work cited above, Boughton (2012); Rhee, Sumulong and Vallé (2013); Kawai and Lombardi (2015); Eichengreen and Woods (2016); Cheng (2016); Medhora (2017); and Roberts, Armijo and Katada (2018).

Instrument (PCI) (IMF 2017e). This instrument provides a vehicle for member governments to commit to policies judged to be sound by the IMF staff, which would monitor compliance over the course of the agreement. The IMF would not provide financing, but the instrument can be used in conjunction with financing from other sources.

The PCI might appear to have been inspired by the IMF's experience in the third Greek program, in which it declined to contribute financing but participated in the design of conditionality and monitored implementation throughout. But countries entering into a PCI agreement would be expected to satisfy upper-credit tranche conditionality and their debt would have to be sustainable. The Seychelles and Serbia have applied for and received PCI arrangements from the IMF (IMF 2017i).

Eventually, RFAs might develop a sufficient indigenous capacity to design and monitor stabilization programs and eliminate the link to the IMF altogether. Europe possesses the analytical capability to do so, although it has retained the IMF for program design and monitoring even when the Fund has not contributed financing. For the RFAs beyond Europe, however, developing such a capacity independently from the Fund would be a vision that could only be realized in the long term and one that would not necessarily be shared by all of these regions' members. In the meantime, RFAs could partner with the IMF through use of the PCI, drawing on the IMF's comparative advantage in designing such programs.⁵⁰

Second, the Fund staff proposed, and the executive board considered, but did not approve, the creation of a Short-term Liquidity Swap (SLS) facility at the IMF. This would be the functional equivalent of a BSA but provided by the IMF rather than a central bank. The staff proposal provided for revolving access, abandoned the expectation that the country would exit and had low usage fees. The proposal failed in part because global financial conditions were benign, and no qualifying country was willing to sign up as the "first mover." But the proposal remains "on the shelf" and

could possibly be adopted at a moment when financial markets become volatile (IMF 2017c).

Such a facility could be attractive for countries in Latin America, East Asia and Europe and could disburse in conjunction with disbursements from the RFAs. Again, the governing bodies of these RFAs would have to decide that SLS qualification satisfies their requirement for the link.⁵¹

Third, to address members' concerns about the use of its precautionary lines, the IMF refined the qualification framework for the Flexible Credit Line (FCL) and the PLL in order to make qualification more predictable. The changes should also facilitate the alignment of the qualification criteria of the Fund's precautionary arrangements with those of the CMIM and the ESM.

Fourth, and fundamentally, the IMF laid out its two visions by which it would collaborate with RFAs in the future — the "lead agency" and the "coherent program design" models. Where the IMF's and RFAs' capabilities are differentiated, the two institutions would defer to one another in their respective areas of comparative advantage when designing and implementing programs. The IMF would take the lead on the macroeconomic framework and policies, for example, while the RFA could address structural reform and areas requiring local knowledge.

The coherent program design model would apply in cases where the overlaps between the capabilities and mandates of the two institutions are large. To pre-empt institutional conflict over program design, and thus avoid inconsistent demands on the debtor, early engagement to fashion a single coherent program was called for in those instances (IMF 2017f, 2, 17, box 3). Officials at the IMF, it would be fair to surmise, expect to follow the coherent program design model in European contingencies and the lead agency model just about everywhere else. The RFA staff response to the IMF paper raised the possibility that an RFA might serve as the lead agency in joint programs (Cheng et al. 2018, 18). Several authors, including Paul Blustein (2016), argue that the European institutions did just that within the troika at the outset of the euro crisis.

50 Whether the RFAs accept an arrangement whereby the IMF defines conditions without contributing financing remains an open question. So far, ASEAN+3 finance and central bank deputies have not judged PCI to satisfy the link on the grounds that it is technical assistance rather than a program in the traditional sense.

51 Proposals that ASEAN+3 accept qualification for IMF precautionary facilities as satisfying the link go back to the Contingent Credit Line and the early years of the Chiang Mai Initiative (Henning 2002). The same pairing concept can be applied to the IMF's current precautionary arrangements. See also Volz (2012).

However, the summing up of the executive board's discussion of the Fund paper on collaboration effectively precludes the IMF deferring to an RFA as the lead agency in the future (IMF 2017j).

The 2017 IMF paper on the RFAs derived six principles for interinstitutional cooperation, which were previewed in the section "Debate over Financial Governance" and Box 2. These effectively supplanted the G20 principles of 2011 (see Box 1).⁵² Reflecting the experience accumulated during the interim, the IMF's principles are more pointed and operationally relevant than the G20 principles. Because the Fund consulted with all of the RFAs in developing them, the IMF principles better relate to arrangements that do not have member countries in the G20.⁵³

The IMF paper is remarkable as an effort to establish the road map for institutional cooperation. It serves to orient and conceptualize the interinstitutional discourse. But it must be said that the IMF principles, even though they were endorsed by the executive board, engage the institutions more than they do the member states. Member state preferences will be a source of entropy; it would be remarkable, indeed a minor miracle, if the major players in key national governments "stayed in their lanes."

Finally, it should be noted that, although the IMF implemented a reform and quota increase in 2016, the resources that are available to it are under renegotiation. At the moment, the IMF's resources amount to about \$1.34 trillion, split roughly evenly between quota contributions and borrowing arrangements with its members. Of the borrowing arrangements, \$250 billion comes from the NAB and \$440 billion comes from bilateral agreements. But, unless they are renewed, the bilateral agreements will expire by the end of 2020 and the NAB will lapse in November 2022 (Truman 2018a). IMF members have agreed in principle to maintain the current level of resources and to discuss a doubling of the NAB (IMF 2019b), but US Treasury Secretary Steven Mnuchin refused an increase in quotas during the fifteenth review (US Treasury 2019).

The United States has a particular responsibility to protect the readiness and vitality of the IMF.

52 See IMF (2017f, 18-19, 36-37); G20 Finance Ministers and Central Bank Governors (2011).

53 RFA feedback on the principles is provided in Cheng et al. (2018, 16-18).

Such responsibility derives not only from the country's status as the largest shareholder and host to the headquarters of the institution, but also from the dominant role of the US dollar as an international currency and a determinant of global financial conditions. The United States routinely deflects to the IMF requests for financial assistance from countries that have liberalized the capital account and subsequently suffer from volatile outflows. Support for the IMF should be the logical counterpart to US strategic interest in open global financial markets. The prospect that the IMF might be underfunded for the next crisis — whether owing to obstinance on the part of the United States or other key members — motivates some EMDCs to consider regional alternatives to the Fund.

Dangers and Remedies

Having reviewed the state of play within the institutions, this report will now consider the dangers associated with having multiple, overlapping institutions in the crisis-finance space. Nine of them are examined in this section: complementarity and competition, compatibility of instruments, moral hazard, private-sector capture, secretariat autonomy, institutional principles, conflict resolution, preferred creditor status and transparency.

Complementarity and Competition

Commentary on the safety net (including some of this author's) routinely advocates that RFAs and the IMF specialize along the lines of the comparative advantage of the institutions. Scholars usually attribute comparative advantage in macroeconomic policy, exchange rates and balance-of-payments analysis to the IMF. Regional institutions are deemed to hold a comparative advantage in select areas of structural policy, microprudential financial regulation, local financial markets and political circumstances within the borrowing member country. From a functionalist standpoint, such a division of labour would conserve resources, avoid duplication and provide more complete coverage of the surveillance waterfront — all of which are particularly important considerations when the resources devoted to surveillance are scarce.

But in this general recommendation lies a fundamental dilemma. Although international economists prize bureaucratic efficiency, the governments that constitute the institutions have other objectives as well. States in Europe, East Asia and Latin America have also created RFAs as *alternatives* to the IMF to avoid monopolization of surveillance and crisis finance on the part of the global multilateral institution. The comparative advantage model leaves member states dependent on each institution for its field of primary competence; the model does not allow for alternative views and analysis of the same problem. Nor does it allow states to pick and choose among the surveillance products with which they are presented or allow them to play one institution off against the other. The latter dynamic might yield suboptimal outcomes substantively, but functional overlap exists because states design institutions to give themselves more, rather than fewer, options. For this reason, the international financial institutions have manifestly *not* evolved along the comparative advantage model.

The dilemma between substantive efficiency and political control manifests in debates over the future direction of each of the institutions. AMRO, for example, wants to show value added to its members over what is already available through surveillance analysis at the IMF, the ADB and ASEAN, among other international organizations. With a total annual budget of about \$19 million, its choice of specialization is strategically important for the institution and potentially relevant to future grants of authority from member states. A specialization strategy would recommend developing a comparative advantage in the micro-foundations of financial markets, structural policy and emergent topics in which the other institutions have not yet built capacity, such as fintech and its consequences for market stability and financial regulation. Given the budget constraint, however, developing these capabilities would mean forgoing capabilities in macroeconomic analysis, debt sustainability and policy conditionality. It would mean, in other words, compromising the ambition to effectively weigh in on the design of country programs with the IMF — an ambition that has motivated support for the project from Southeast Asian countries from its inception. Accordingly, AMRO has chosen to develop capacity in areas that significantly overlap those of the IMF in macroeconomic analysis, financial vulnerability and

spillover, and has adopted the style of the Fund's Article IV reports in its surveillance publications.

The European institutions, with more resources at their disposal, are developing with an even greater degree of overlap with the Fund. While there is considerable discussion within Europe about the relative competences of the ESM, the European Commission and the ECB, and how they should evolve, developing complementarities with the IMF is not a priority. On the contrary, European authorities have designed euro-area lending capabilities to be deployable in circumstances in which the IMF might be unable or unwilling to participate.

We are left with a tension between developing complementary or potentially competing capacity in the RFAs that, while manageable, is persistent. But there is an important difference between the areas of program design and conditionality, on the one hand, and economic analysis and surveillance, on the other. Whereas competition in the former can undermine programs, competition among the RFAs and the Fund in surveillance can benefit member states, notwithstanding the stress it might place on secretariats. By providing a broader range of methods, models and forecasts, for example, competition permits states to compare and evaluate analysis, avoiding groupthink on the part of a single institution.⁵⁴ There is, of course, the danger that competing recommendations will dilute the impact of advice that institutions convey in bilateral surveillance, but there is also the possibility that, when institutions happen to agree, they reinforce one another and induce greater corrective action in member states.

As a general matter, international organizations often sponsor, nurture or even create other institutions that help them advance their missions.⁵⁵ The IMF has done the same in a number of circumstances. The most consequential case has probably been the Fund's intellectual and analytical support for institutional and economic deepening of the monetary union in Europe — completing Europe's monetary union could potentially put the IMF “out of business” in the

⁵⁴ On institutional competition in the euro crisis, see Henning (2017, 26-27, 241, 246-47). On the implication of different types of spillover on institutional cooperation, see Johnson and Urpelainen (2012).

⁵⁵ See, relatedly, Johnson (2014) and Abbott et al. (2015).

euro area, but the institution has intellectually supported such deepening nonetheless.

Similarly, the IMF has been called upon to support the RFAs' capacity building through training, technical assistance, joint meetings and conferences, joint country missions and staff exchanges. How should the IMF answer this call? The question poses a dilemma for the Fund. On the one hand, it has an institutional interest in developing sophisticated, like-minded and compatible partners in the regional institutions, and training and capacity development is one way to foster these. On the other hand, the Fund has little interest bureaucratically in empowering institutional competitors, which is the purpose for which some advocate the RFAs.

As a practical matter, the dilemma will ultimately be resolved by the preferences of key member states. When the leading creditor countries in the Fund and region favour IMF support for the RFA, the Fund can be expected to provide it, as was the case with IMF support for European deepening. The answer thus hinges on the preferences of linchpin countries, those that lead the region and are influential within the Fund — Germany and France, China and Japan, and Brazil and Mexico.⁵⁶ The United States, while influential in other respects, is not a linchpin country because it does not straddle the Fund and these regions.⁵⁷

Compatibility of Instruments

Even if institutions wish to preserve the option of operating independently, their lending instruments should be designed to work together in those situations where cooperation is needed or desirable. There are several ways in which such technical complementarity can be encouraged and incompatibilities pre-empted. These relate to the design features of the lending windows, standards of qualification and evaluation processes.

The Fund's engagement with ASEAN+3 over the test runs for CMIM revealed several incompatibilities. ASEAN+3 has adjusted the terms of the CMIM-SF to more closely match those of the Fund's SBA, which demonstrates a certain amount of

alacrity and responsiveness. The IMF has designed several of its facilities specifically to be able to join them with facilities of other institutions, the PCI being a case in point. European officials should be mindful of interoperability as they introduce enhancements of the ESM and consider operationalization of the ECB's outright monetary transactions. Having shown their value in highlighting points of friction among instruments and decision-making procedures in East Asia, test runs should be employed to identify and "debug" similar incompatibilities between the lending instruments of other RFAs and the IMF. The institutions should review their instruments on an ongoing basis with an eye toward compatibility.

Precautionary arrangements offer another opportunity for institutional synergy. Confusion could arise if institutions apply different criteria for qualification for such facilities, which could undermine market confidence and thus be self-defeating. Care should be taken to align the criteria and evaluate them similarly. Because the IMF is most advanced in this respect, alignment effectively means convergence on the Fund's precautionary framework (IMF 2017b).

Precautionary instruments create a substantial burden on secretariats to monitor and evaluate economic policies of potential applicants. Several RFAs are in the process of developing such capacities. But until their surveillance is robust and independent, RFAs can link to the IMF for *ex ante* qualification for precautionary arrangements. RFAs should accept the IMF's qualification of members for an FCL as sufficient for qualifying their own members for precautionary arrangements from within the region. The same principle would apply to PLL qualification at the Fund and regional precautionary windows with lower thresholds. Both regular qualification as it is now practised for the FCL and pre-qualification as has been proposed should qualify members for regional precautionary lines (IMF 2010; Truman 2010; Rajan 2014).⁵⁸

Any RFA that does develop its own capacity in this respect will want to align its qualification criteria with those of the IMF's precautionary lines — if it envisions joint qualification at the two institutions. Some RFAs might resist doing so if they believe that the Fund's criteria are too strict. But if they decline to align the criteria, they would have to be prepared

56 On the roles of large emerging-market countries in financial governance, see Kahler (2013; 2016), Lombardi and Wang (2015); Henning and Walter (2016); Helleiner (2017).

57 Except insofar as it maintains the North American Framework Agreement and could utilize or expand that agreement in the future.

58 See also Birdsall, Rojas-Suarez and Diofasi (2017).

to provide full precautionary coverage for a country that meets the lower regional threshold but fails to meet the Fund's, which could be quite large.

The SLS was neither adopted nor rejected by the executive board of the IMF in early 2017. It could, in principle, be revived in the future,⁵⁹ especially if needed in a crisis. Regional facilities should prepare for that contingency and consider how, whether and on what terms to mobilize their own liquidity provision along with it.

Qualification for the FCL at the Fund can also be linked to BSAs.⁶⁰ Countries that qualify for an FCL under the criteria used by the IMF and establish an FCL agreement should be eligible for swap agreements with key-currency central banks. This proposal could open up access to central bank swaps to a limited but still significant number of countries that do not now have access to them.⁶¹ Key-currency central banks would not be legally compelled to provide swaps, but there should be a normative presumption that FCL qualifiers would receive them and governors who refuse should have to justify their decision in closed-door meetings with their peers. Countries that do not qualify for an FCL — which describes all six advanced countries in the permanent swap network — should not be barred from swaps from central banks that are willing to provide them (Henning 2015).

Moral Hazard

The regime complex for crisis finance must avoid allowing the institutions to be picked apart by financial markets, states or other actors when they finance programs jointly. The problem arises at multiple stages of a crisis and rescue: the debt-accumulation phase, the choice of institutional arrangements, design of the program, periodic post-disbursement review and repayment. We can expect the problem to be aggravated by institutional competition and a multiplicity of financial facilities operating in the crisis rescue space. The problem goes beyond mere forum shopping on the part of borrowers; private actors sometimes coordinate their movements

through the financial markets and, in the case of predatory hedge funds, for example, have shown themselves to be adept at gaming the institutions.

Until now, the institutions, to the extent that they have responded to the moral hazard threat, have done so more or less independently. The IMF's lending framework, like self-commitment devices in other contexts, uses institutional rules to pre-empt temptation in the midst of crises to deploy financing with insufficient adjustment or inadequate debt restructuring in order to combat systemic financial disruption. Of course, the protection against moral hazard is imperfect, insofar as the governing bodies that adopt the rules can change them in a crisis. But these rules nonetheless raise the cost of bailing out excessive lending and letting off "guilty" private creditors.

Weder di Mauro and Zettelmeyer (2017) have led the charge against moral hazard in the context of the RFAs and their interaction with the IMF. Informed primarily by the European case, and the experience with the Greek program in particular, they worry that the multiple sources of financing in the expanded GFSN provide incentives for markets and governments to accumulate excessive debt *ex ante* and provide soft financing *ex post*. (Financing is "soft" when the adjustment is insufficient to restore access to private markets or debt restructuring is insufficient to ensure sustainability.) They examine alternative strategies for using the institutions as commitment devices to constrain the temptation to soften the terms of financing in a crisis.

Scrutinizing the troika programs for Greece, the authors are critical of the European RFA for migrating from a hard lender of last resort to a provider of soft financing. In their interpretation, the IMF was included in the troika arrangement as just such a device, to anchor the programs in realism with respect to debt restructuring. But it failed to serve this role, in their view. They conclude that "using the IMF as a commitment device may not be a reliable, politically viable option for an RFA — even for an arrangement that builds this commitment device into its charter and is keen to make it work" (Weder di Mauro and Zettelmeyer 2017, 31-32). When the IMF dug in its heels on debt sustainability for Greece during the negotiations over the third program, the European institutions abandoned the anchor and lent to Greece anyway.

Weder di Mauro and Zettelmeyer raise this warning in part because they were concerned

59 The Geneva Report, for example, proposed a more robust variant of the SLS proposal.

60 On central bank swap agreements, see, among others, Prasad (2017); McDowell (2017); Sheets, Truman and Lowery (2018); and Eichengreen, Lombardi and Malkin (2018).

61 For similar or related proposals, see Truman (2010), Rajan (2014), Henning (2015) and Weder di Mauro and Zettelmeyer (2017).

about the shift in the IMF lending framework in the wake of changes in its Exceptional Access Policy (EAP) in early 2016. Along with revoking the systemic exemption, the Fund introduced a new category between the two cases of debt being either clearly sustainable or clearly unsustainable. In cases of uncertainty about sustainability, the so-called “gray zone,” one of two things would have to happen before the IMF could grant exceptional access. Either there would be a definitive debt restructuring or other lenders would provide concessional finance that improves the prospects for sustainability and safeguards IMF resources (IMF 2015a, 9).

The provision was intended to address European complaints that the Fund was too inflexible and unwilling to grant access when the European institutions were effectively underpinning sustainability through their long-term commitments to members of the euro area. By creating the gray zone, some euro-area countries could draw on the Fund insofar as the European institutions were willing to provide the bulk of financing on concessional terms. The provision would also have the felicitous by-product of allowing the Fund to avoid risk associated with lending into cases of dubious sustainability in conjunction with RFAs while alleviating tension between the diversity among them, on the one hand, and the equal-treatment provisions of the IMF, on the other. To the extent that programs were custom fit to the preferences of the region, the RFAs themselves would provide the element of variation, not the Fund.

But Weder di Mauro and Zettelmeyer (2017) perceptively point out that the change interacts with the IMF link on the part of RFAs in an unanticipated way (see pages 40–42 as well). By allowing an RFA to contribute additional financing in cases of uncertain sustainability, the new EAP weakens, if not eviscerates, the value of the IMF link as a safeguard against moral hazard in this particular form.⁶²

Weder di Mauro and Zettelmeyer’s solution to this problem is for RFAs to develop their own lending frameworks and exceptional access policies,

including conducting their own DSAs. The time was ripe for the non-European RFAs to develop such frameworks, they wrote in 2017, while debt was relatively low and it was still possible to pre-empt excessive accumulation. Such a solution would inevitably involve the RFAs defining their own policy conditionality in cases of both sustainability and reprofiling. If RFAs were to take the Weder di Mauro and Zettelmeyer advice, in other words, they would be well on their way to becoming regional monetary funds in their own right.

By way of evaluation, there are several points to make about this important set of arguments.

First, the review conducted here of the recent developments among the RFAs suggests that risks of moral hazard vary substantially among the regional facilities according to their degree of development. The European arrangements are most prone to moral hazard on the part of sovereign borrowers and private banks and investors, owing to the size of the ESM and the demonstrated willingness of members to deploy it. But the ASEAN+3 and Latin American institutions are a different matter: the CMIM has never been used and will have very little credibility with markets until it is activated. Given its lack of visibility, it is not plausible that the CMIM’s mere existence could be encouraging excessive lending. Relative to the CMIM, FLAR has been quite active and several of its loans have gone to countries whose adjustment has been partial rather than complete. But any contribution that FLAR might make to *ex ante* moral hazard would be constrained by its relatively small size.

Second, granularity provided in this review helps to discern the different ways in which moral hazard is and is not a threat. Newer, smaller RFAs are not likely to induce excessive risk taking *ex ante*, but they could be ensnared in soft lending for bailouts *ex post*. Also, if smaller RFAs were to move outward along a trajectory toward more fully fledged regional monetary funds, they would then need safeguards against lending into situations where debt is unsustainable. Doing so would naturally be facilitated by greater progress in developing an international sovereign debt restructuring regime.⁶³

62 Somewhat ironically, the change does not satisfy some other Europeans, who are concerned that the ESM and other European institutions would end up shouldering most or all of the risk of these operations as a consequence. This concern is hinted at, although implicitly, in the RFA staff paper by Gong Cheng et al. (2018).

63 Space requires that SDRM regimes be left for treatment elsewhere. See, for example, Committee on International Economic Policy and Reform (2013).

Third, if the ESM were enhanced and ever delinked from the IMF, it would definitely need to be given stronger safeguards than are now envisioned.⁶⁴ For this reason, the ambiguity within European arrangements with respect to the involvement of the IMF should be worrisome. It is understandable that Europeans would not want to give the Fund a veto over assistance to members of the euro area. But proceeding to a program on a Europe-only basis without such a framework in place would be potentially dangerous. European officials should prioritize the further development of regional arrangements for debt restructuring in future deliberations over the architecture of the euro area if they wish to keep open the option of developing programs independently from the IMF.

Fourth, if RFAs develop lending frameworks to control moral hazard, the consistency of their frameworks with that of the Fund becomes a serious question. If RFAs were to simply copy the Fund's EAP, there would be little conflict. But they would probably not embark on this course, as opposed to simply using the Fund as the anchor, unless they wanted a *different* framework, in which case the flashpoints between them and the Fund would multiply. (The lead-agency model would probably not be feasible in such circumstances.) If RFAs adopt such lending frameworks, therefore, they should be prepared to go their own way — as the European institutions did when they encountered irreconcilable differences with the IMF on the DSA for the third Greek program. At this point in time, however, a significant number of euro-area officials still prefer to avoid this course and the RFAs outside Europe are not equipped to address a large-scale crisis independently.

Capture

Institutional overlap also gives rise to multiple avenues for private capture of official institutions and the processes by which decisions on financial assistance are made, as it does with respect to moral hazard.⁶⁵ Private creditors are sometimes well placed to cajole, influence or threaten officials in order to manipulate the complex of institutions to their advantage — by, among other means, holding “innocent bystanders” hostage for bailouts. Those responsible for designing

financial rescues should be alert to the possibility that, as one institution erects safeguards against abuse (such as the IMF's lending framework and reprofiling requirements), private or official lenders who have lent imprudently simply exploit other institutions in the safety net. The design of the safety net should pre-empt the circumvention of safeguards against capture and moral hazard.

Governance is critically important to understanding the risk of capture and moral hazard. These risks do not arise simply owing to regulation and the structure of markets; they inhere also in how institutions make decisions, the reversibility of self-commitment and the avenues for private manipulation. The close connection between governance, on the one hand, and moral hazard and capture, on the other, gives rise to three further observations.

First, because the influence of different regions varies within the IMF, that institution provides better defence against capture and moral hazard for some regions than others. The Fund's commitment to requiring that private creditors reprofile debt in cases of unsustainability will be stronger and more credible for regions that have lesser voting strength within the executive board. Self-commitment is more difficult and time inconsistency a greater danger in the case of Europe, because that region can use its greater voting strength to nudge the institution to back off from strong anti-bailout commitments that are taken *ex ante*.

Second, it follows that the IMF's effectiveness as an anchor against moral hazard will change as the weight of countries and their regions change over time in the quota and voting structure of the Fund. Specifically, as voting shares shift from Europe to the EMDCs, the IMF can be expected to be a *stronger* anchor for contingencies in Europe. But the shift will have the unintended consequence of making it a *weaker* anchor for those regions with growing shares, especially East Asia and South Asia. While the quota and voting structure of the Fund should certainly be made more representative of countries' actual weight in the global economy and finance, this problem should be anticipated.

The IMF is certainly susceptible to heavy influence on the part of large shareholders such as the United States, China and European members. Nonetheless, third, the Fund on the whole is likely to provide better defence against capture and moral hazard than RFAs, for several

64 A warning sounded by Weder di Mauro and Zettelmeyer (2017).

65 Capture can occur even when excessive risk taking is not involved and so, while related, is conceptually distinct from moral hazard.

reasons. The IMF's universal membership makes it more expensive to capture than regional institutions. While changes to its articles require a supermajority, no single country can veto lending decisions or thus hold the institution hostage over individual programs. Compared to the regional arrangements, decision making at the IMF is more "distant" from the politics within member states. A liability in terms of responsiveness and legitimacy, such remoteness can be an asset in resisting narrow, private interests. The Fund's value as an anchor is not obsolete.

Institutional Independence

Inspired by the example of central bank independence, the Geneva Report proposes granting the IMF staff operational autonomy in the design of programs and disbursement of financial assistance. The executive board could thereby be disbanded and replaced by a more senior-level non-resident body meeting six to eight times a year, to which management would be accountable. The proposal is important in the context of this particular analysis because the Fund's organizational arrangements have informed the development of RFAs and changes in the Fund's organizational structure would affect its interaction with other IFIs.

Because the word "independence" is used in a variety of ways in global governance discourse, its meaning in this essay should be precise: the autonomy with which staff and management make decisions, conduct operations and pursue the objectives of the institution — specifically, their autonomy from direction or influence on the part of the governments of member states. Under the proposal offered by the Geneva Report (de Gregorio et al. 2018, 72-73), Fund management would be operationally independent, while its goals would be set in an amendment to the Articles of Agreement and a new, non-resident board would oversee performance relative to those goals.⁶⁶

The report's case for applying the central bank independence model rests on time inconsistency (going back to Kydland and Prescott 1977) and political capture. Barry Eichengreen argues that the IMF also suffers from time inconsistency with respect to lending to countries whose debt is not sustainable (de Gregorio et al. 2018, 89).

It might declare *ex ante* that it will not do so, but, when push comes to shove, it proves to be susceptible to pleas from executive directors whose countries are suffering from contagion in anticipation of default or restructuring. The first Greek program is offered as a paradigmatic case.

Discussion of the proposal focused on the appropriateness of the central banking model to crisis finance.⁶⁷ The IMF's own IEO produced an update of a previous report on Fund governance at about the same time that the Geneva Report was published (IEO 2008 and 2018). The IEO was reasonably satisfied by the effectiveness and efficiency of IMF governance but concluded that continuing problems of accountability and voice could weaken the Fund's legitimacy and, eventually, effectiveness. Its director, Charles Collyns (2018), expressed concern that distancing program approval and lending decisions from national governments, as the Geneva Report recommended, would further weaken the Fund's accountability and legitimacy, not strengthen them.

The EPG report takes a nuanced view on governance within the international financial institutions. Analyzing the budgets of the executive boards and frequency of meetings, the group generally advocated greater delegation to management depending on the level of risk involved in the decision. The boards themselves should focus on strategic priorities for the institution and on holding management to account for advancing them. But, in the case of the IMF, "surveillance and lending programs may involve broader considerations that require Board discussion" (G20 EPG 2018, 73-75; in particular footnote 83).

So, how should architects of financial institutions weigh these competing arguments? This study agrees that reform of the executive board would be desirable but takes the view that it should retain political responsibility for program approvals. This is for two reasons, one that is reasonably familiar to analysis of financial crises, another that arises only in the context of institutional complexity and is thus relatively novel.

First, the distinction between liquidity provision and risk-bearing crisis finance bears on the choice of location of lending decisions. Central banks

⁶⁶ The distinction between goal and instrument independence is a feature of the Bank of England (Tucker 2018).

⁶⁷ In the Geneva Report, see Jeffrey Frieden's comments about political constraints (de Gregorio et al. 2018, 79-81) and responses by Jean Pierre Landau and Takatoshi Ito (*ibid.*, 81-83, 88).

provide liquidity for solvent institutions on good collateral and thus avoid, or in principle seek to avoid, financial losses that have fiscal, and thus distributive, effects. When banks need to be recapitalized, or when sovereigns need to be rescued, governments should carry the burden, because it comes with serious risk of fiscal losses even when rescues are ultimately successful. (The “broadening” of central banking since the global financial crisis involves accepting greater risk, but arrangements in Britain and the United States placed a significant amount of it on the shoulders of governments as the central banks provided liquidity. Likewise, the profits from risk bearing also rightly belong to governments.) This division of labour keeps decisions that have potential fiscal consequences close to national legislatures with democratic accountability.

Decisions of the IMF mobilize tens of billions of dollars in some cases and have political consequences that can be far-reaching, even when there is no fiscal cost involved. Realistically, given the magnitude of the political costs and benefits, it is hard to see governments delegating these decisions to a team led by the managing director. Nor is it likely that such a team, if given such autonomy, could keep it through a severe crisis. To see why, consider again the case of the first Greek program.

The EAP of the Fund that was in effect prior to the program required a debt reprofiling or restructuring as a condition for IMF assistance, because the staff was not willing to certify Greece as sustainable with high probability. The provision was suspended for cases that threatened the stability of the financial system more broadly — the “systemic exemption” — at the eleventh hour in the same meeting of the executive board that approved the program. Note that the Fund staff, while under considerable pressure, refused to say that debt was sustainable with high probability. Staff maintained its analytical independence; it was not bowled over by politically motivated members. It was the executive board that took the political decision to lend and, if necessary, seek debt restructuring after the fact, knowing that many (irresponsible) creditors would “escape” in the meantime. The executive directors held their nose and approved the program because they feared provoking a “second Lehman” if they rejected it.

Now, let us rerun the scenario under the assumption that the managing director exercises

the authority to design and approve the program.⁶⁸ The staff’s DSA shows that Greece does not meet the sustainability criteria defined in the EAP and the managing director thus requires private banks to write off a large portion of debt prior to committing IMF resources. Let us also assume, perhaps even less plausibly, that the European countries choose to act in solidarity by declining to lend until a restructuring of private debt is agreed.

Under this scenario, the decision of the managing director would trigger large losses in financial markets and private banks, hardship for at least some “innocent bystanders,” and even perhaps a recession in some countries. We can hope that a second Lehman would be smaller than the first. By acting proactively, the managing director could be doing the global system a favour in this respect. Moreover, these losses would not of course be her fault; they were baked into the myopic decisions of myriad banks and investors during the buildup of excessive debt.⁶⁹

However, even if the scenario is ultimately less costly than would otherwise be the case, *it matters who triggers the losses*. Many national governments would be delighted to shed the political responsibility for either triggering the crisis or bearing the costs of financial rescues. But the managing director would not withstand the political blowback alone and political support within member countries for the IMF would be, at a minimum, severely damaged. A wise managing director would insist that member states stand with her, taking political responsibility before the public, on a decision of such consequence, whether it is to force a restructuring or kick the can down the road.

The second reason to keep consequential, risk-bearing financial decisions of the IMF in the hands of a body that is constituted by political authorities of the member states stems from the relationships among institutions in a complex like the GFSN. We see from the euro crisis that the member states mediated conflicts among the institutions in the troika when those conflicts became severe. They are empowered to do so in part because of the formal and informal influence that they hold in the institutions’ governing bodies (Henning

⁶⁸ Further assume that the managing director was not personally predisposed to intervene, as was Dominique Strauss-Kahn.

⁶⁹ Matters would be different with a sovereign debt restructuring mechanism in place that reduces the cost of such operations. But, of course, we cannot assume that to be the case.

2017). We also find that, in general, discretion in international financial institutions is concentrated at the top, in the executive boards, whereas staff is constrained by rules. If exceptions are to be made, the large member states with sway within the institution want to be distributing the benefits that stem from doing so. When institutions work together, secretariats cooperating alone, being less flexible, are prone to impasses that are likely to require the intercession of key states to overcome. Granting operational autonomy to secretariats would weaken the informal mediating role of states that are represented on the board. Institutional conflict would be more difficult to resolve, unless some alternative mechanism were created.

In sum, responsibilities should be defined in the following way: The staff and management of the international financial institutions, the RFAs and the IMF alike, should be granted full autonomy in the technical and analytical functions underpinning surveillance, program design, policy conditionality, DSA, and monitoring and assessment of program implementation on the part of the borrower. The integrity of the analysis, including the macroeconomic consequences of policy adjustments in borrowing countries, should be absolute, or at least as insulated as possible. But program approvals, being inescapably political, should be the province of a board with political responsibility. It would be difficult, if not impossible, for the board to enforce overall performance goals without approval authority for individual programs, moreover. Aside from aligning competence with risk bearing and breadth of consequence, this division of responsibility provides greater latitude for key members to mediate compromises among the institutions when that becomes necessary.

Principles for Institutional Cooperation

The IMF's six principles of 2017 effectively supplant the G20 principles of 2011 and provide guidance that is somewhat more operational. But the IMF principles primarily address the Fund and its peer institutions, as opposed to the behaviour and policies of governments.⁷⁰ They are thus not a substitute for principles that are adopted by, and thus obligate, member states *directly*. It is

the member states that circumvent or support the institutions and mediate interinstitutional conflict. Securing their adherence would constrain forum shopping, transparency arbitrage and so forth, and thus heavily influence the quality of institutional cooperation. Countries themselves, in particular the linchpin countries straddling the IMF and the regional arrangements, should therefore commit to the new principles directly, for which the G20 would again be an appropriate forum.

Conflict Resolution

How are conflicts among the institutions that are called upon to cooperate in the GFSN to be reconciled? The EPG Report (G20 EPG 2018, 72) advocates vigorous dialogue among the RFAs and the IMF to facilitate cooperation but otherwise offers little guidance on this particular question. The Geneva Report, on the other hand, proposes binding arbitration of disputes by a three-person panel chaired by a neutral expert, a procedure modelled on investment dispute resolution. Its authors suggest that such a procedure would have been helpful in resolving the disagreement between the IMF and European institutions over Greek debt sustainability in spring 2010. Arbitrators would need to have access to specialized experts and produce a settlement quickly, within the compressed time horizon of program negotiations.

The Fund itself has taken the view that formal dispute resolution would be “counterproductive,” and any binding mechanism would run afoul of the principle that decisions must comply with each institution's own policies and governance structures (which it calls the “independence principle”). Institutions must seek coherent program design while respecting differences among them with respect to lending practices. This way, if institutions cannot agree, which the Fund expects to be rare, the member state can borrow from one of them alone (IMF 2017f, 26).

Which of the two is the better path? Understanding how interinstitutional conflict was resolved in the leading case of interaction between the Fund and regional institutions, the euro crisis, is helpful in answering this question. Informal mechanisms were essential for resolving interinstitutional conflict during those programs. Time and again, interinstitutional deadlock was resolved by the mediation of key member states — sometimes the Group of Seven (G7) finance ministers, sometimes the German chancellor, and so forth. Because

⁷⁰ The ECB's IRC Taskforce (2018) offers specific ways to develop the G20 principles on the basis of dialogue between the IMF and RFAs.

mediation serves to maintain key-state control over program design, states tend to *underinvest* in mechanisms that might otherwise anticipate and resolve institutional conflict *ex ante*.

This central observation leads to two important conclusions. First, mechanisms of *ex ante* coordination of intergovernmental institutions are rarely if ever going to satisfy architects who take a functionalist approach to the design of regime complexes. Second, informality is thus one of those parameters within which we must design mechanisms to resolve conflicts among institutions.

When designing institutions and bringing them together in a mix such as that for the euro-crisis programs, the mechanisms of *informal* coordination by member states should be nurtured rather than expunged because they operate in the shadows.⁷¹ Space can be created for informality even within the formal provisions of institutions, legitimizing member-state mediation when institutions are deadlocked. Informal mediation can be brought into the open, at least in substantial measure, by announcing meetings and consultations and providing greater disclosure of their results.

The effectiveness of informal mediation of institutional disputes by key states depends, in turn, on a convergence of preferences among them. Coordination worked satisfactorily enough from the standpoint of the European creditor states over the course of the crisis programs. But the robustness of this model for mediation is vulnerable to changes in governments, leaders and ministers. As the Trump administration launches one dispute after another with long-standing US partners, trade and foreign policy disputes could spill over into financial cooperation. We can work to make coordination robust to changes in state preferences, by facilitating staff-level resolution, but there will be limits to accomplishing this in intergovernmental institutions such as these.

Consider, finally, informal mediation in light of the movement to accommodate emerging-market countries in global institutions. The convention under which the managing director of the IMF has always been a European, while anachronistic,

greatly facilitates informal coordination between the Fund and the European institutions. Appointing a non-European to lead the Fund might strengthen the Fund's relationship with institutions in Asia, Africa or Latin America, but it would likely have the unintended consequence of weakening informal cooperation with Europe. Thus, while the Bretton Woods institutions should discard the convention, new channels would have to be created in order to avoid deterioration in cooperation with European institutions.

Preferred Creditor Status

Any situation that involves multiple lenders poses the question of creditor seniority, that is, the hierarchy in which creditors are repaid when the debtor cannot make good on its commitments to all of them. The IMF has traditionally claimed and been accorded the status of preferred creditor, at the apex of the hierarchy. This status has been established as a matter of customary law through successive debt workouts over the decades.⁷² But, because it is not explicitly stated in the Fund's Articles of Agreement, the status is questioned from time to time and defenders of the Fund take pains to reinforce it on an ongoing basis.

The challenges have come from somewhat surprising quarters, including people who have formerly worked at the Fund or been closely involved in international finance. During the European debt crisis, some officials questioned the seniority of the Fund when they were being asked for official sector involvement.⁷³ Susan Schadler (2013, and especially 2014) argued that the case for preferred status for the IMF rested on the Fund's lending policies and that the first Greek program, adopted along with the "systemic exemption," undermined that case. Preferred creditor status inevitably creates moral hazard on the part of the Fund, she argued, weakening the incentive to be vigilant when lending to countries whose debt sustainability was dubious. By having "skin in the game," as some Europeans liked to say during the euro crisis, the IMF would face a more balanced set of incentives and lend less liberally. With changes to the lending framework of the Fund in 2016, the systemic exemption was revoked, in part to address such concerns.

71 The legitimacy of back-channel mediation is admittedly vulnerable without better transparency and communication. Officials from countries outside the euro area and the G7 criticized the shallowness of staff consultation with the executive board early in the euro crisis, for example (de Las Casas 2016).

72 See Martha (1990; 2015, chapter 50) and Lastra (2014).

73 See, for example, Spink (2013), cited by Schadler (2014).

Of course, the IMF's status might also be challenged by other international organizations that are similarly exposed in a restructuring. That could potentially include the RFAs, although it is important to point out that the ESM has indicated that it would defer to the IMF, while it claims seniority over all other creditors. Accordingly, both the G20 principles and the IMF's six principles state clearly that the IMF should be accorded preferred creditor status.

There are several good reasons for treating the IMF as the preferred creditor, senior even to the RFAs. To condense a broad-ranging argument, the IMF is available, in principle, for all sovereign borrowers, takes on the most difficult cases and thus carries a high-risk portfolio. Its responsibilities in these respects, moreover, are fundamental to maintaining the stability of the international financial system as a whole. If a regional arrangement attempts but fails to treat a crisis on its own, the problem will migrate to the global multilateral institution, in this sense a lender of last resort. If the IMF is to remain at the "centre" of the global safety net, states that contribute to it must know that their financial support is not subordinate to that of other creditors. At the same time, the participation of the RFAs and other creditors in joint programs allows the IMF's financial contribution to be smaller than it would be otherwise, which limits the pain involved in respecting the preferred position of the Fund.

To conclude, member states and other creditors should respect and uphold the preferred creditor status of the IMF. If ever the occasion permits, this status should be formalized in the Fund's Articles of Agreement. The RFAs should have status that, while subordinate to the Fund, is senior to other creditors, as the ESM has asserted. We should guard against the possibility that one member state or another will assert status for its RFA that is senior to that of the Fund when and if its regional arrangement is developed further.

Transparency

The IMF has become progressively more transparent over the last two decades and has outpaced most of the other institutions in this respect. While the ESM is relatively advanced in terms of transparency, other RFAs operate largely confidentially. ASEAN+3 authorities, for example, have published summaries of the CMIM Agreement, but they have never published the agreement itself.⁷⁴ The discrepancy is likely to be problematic in cases of co-financing with the IMF at a couple of different levels. It can give rise to transparency arbitrage, driving some functions or decisions toward the least transparent institution in the institutional team. It can impede the sharing of crucial information among institutions. And the discrepancy can impinge on communication when, for example, two institutions are called upon to explain a joint program at the rollout press conference. The practice of the most transparent institution, not the least transparent, should set the standard for cooperation between them.

Improvements in transparency would be vital if and when RFAs tool up for a broader range of activities, including program design and policy conditionality. They cannot be overseeing adjustment programs, which will be controversial domestically, without being at least as forthcoming about their analysis and rationales as the IMF. Failure to advance along this dimension would weaken their credibility in financial markets and their political standing within their member states. Reliance on informal approaches to dispute resolution renders transparency all the more important. Although it has been made before, the point is worth stressing because transparency is *not* included in either the G20 or the IMF principles for institutional collaboration.

74 Central bank swap arrangements also vary considerably in their level of transparency. The US Federal Reserve posts the text of its swap agreements on its website and drawings are recorded in statistical releases weekly. See, for example, US Federal Reserve (2010). The People's Bank of China, on the other hand, posts relatively little.

Conclusion

This report reviews several of the important conceptual and policy issues surrounding RFAs and their relationships to the IMF, as global financial governance becomes more complex. Specifically, it assesses the benefits and pitfalls of having multiple, overlapping institutions involved in crisis finance. Three RFAs are examined in depth: FLAR, the ASEAN+3 institutions and the ESM — a group that presents the range of issues that can arise. The analysis stresses the normative distinction between designing institutions for functional purposes versus the political-institutional imperatives of the member states that create them. Notwithstanding the vision of many architects for more efficient institutional coordination, member states' insistence on control over outcomes limits what can be achieved in advance of crises. Rather than being organized *ex ante*, therefore, institutional coordination will largely be mediated by key member states *ex post*.

The previous section detailed the study's findings with respect to the dangers of institutional overlap, four of which are highlighted here. First, while harmful in some areas, such as program conditionality, institutional competition can be beneficial in other areas, such as economic analysis, forecasting and surveillance. Second, while it pervades crisis rescues, the threat of moral hazard varies substantially across regional arrangements and is critically dependent on institutional governance. Accordingly, moral hazard will vary as regions' influence within the IMF evolves over time with reallocation of voting shares. Third, while the staffs of these institutions should have autonomy in the technical analysis underpinning surveillance and lending programs, program approval should remain the province of boards with political responsibility. Among other things, such a division of responsibility protects the mediating role of key principals in resolving disputes among institutions informally. Finally, the report defends the preferred creditor status of the IMF and calls on RFAs to, at a minimum, match the (generally greater) transparency of the Fund.

Owing to the global reach of financial markets and economies of scope and agglomeration in economic surveillance, analysis and program design, the IMF has traditionally been at the centre of the GFSN. The link, which is present as either a formal or de facto

matter in most RFAs, is one principal manifestation of the Fund's central position — the glue that coheres the safety net. While RFAs or even central bank swap agreements conduct modest-sized or short-term operations, therefore, crises in countries that require prolonged adjustment and large loans remain the province of programs that involve the IMF. Europe can, in principle, design and implement adjustment programs independently, but for a number of political and institutional reasons has not made a clean break from the Fund.

Historically, discourse over the development of RFAs surrounds the question of whether they weaken the centrality of the IMF or the collective discipline of the safety net when delivering assistance. But, rather than develop one at the expense of the other, this report recommends that *both* the RFAs and the IMF be developed further. As a general matter, after all, the resources for economic policy surveillance, crisis prevention and post-crisis financial stabilization remain chronically undersupplied in global financial governance.

However, the approach to crisis fighting in which the IMF is central is under threat from a different quarter: nationalism in the countries on whose support the IMF has been most reliant. Those countries include the two that were principally responsible for creating the Bretton Woods institutions, the United States and the United Kingdom, and extend to several other European and large emerging-market countries. Such nationalism threatens to deny the IMF and other institutions adequate resources and block the provision of financial assistance.

Under such circumstances, the development of RFAs and other financial facilities provides insurance against the possibility that the IMF might become unavailable in a crisis. Development of RFAs is desirable for this reason, among others. But architects of governance must recognize that nationalism can rebound against regional institutions as well. So, the reverse could also apply: the IMF can provide insurance against immobilization of regional finance. By creating alternative institutional pathways for financial assistance, in other words, greater institutional overlap and complexity helps to avoid monopolization and weakens the chokehold of narrowly self-serving nationalist leaders.

Designing global financial governance in this way requires protecting the ability of the RFAs to act

independently if the IMF were to be immobilized. But it also requires maintaining the ability of regional institutions to cooperate with the IMF in the hope and expectation that the Fund continues to receive support from its principal stakeholders and deserves its central place in the regime complex for crisis finance. By these strategies, architects of governance can build both coherence and resilience into the GFSN.

Author's Note

The author wishes to acknowledge the Centre for International Governance Innovation (CIGI) for supporting the project under which this report was written and numerous officials in governments, central banks and international institutions who contributed valuable insights in meetings and interviews for the study. He also thanks James Boughton, Guy Debelle, Meg Lundsager, Russell Kincaid, Louis Pauly, Nathan Porter, Ika Mustika Sari, Edwin Truman, Andrew Walter, Wei Benhua, Marty Weiss, Xiong Aizong, Zhang Zhixiang, Zheng Liansheng and two thoughtful anonymous reviewers, all of whom provided written comments on previous versions of the manuscript. Oral comments from He Fan, Gao Haihong, Miles Kahler, Robert Kahn, Cao Li, Zhang Liqing, Dongmin Liu, Zhang Ming, Cecilia Nahon, Xu Qiyuan, Rasmus Ruffer, Nicolas Véron and Wang Xin also greatly improved the final version. The study benefited substantially from seminars held at American University, Renmin University, the Chinese Academy of Social Sciences, Central University of Finance and Economics (Beijing) and the Treasury of Australia (Canberra). Sahil Mathur and Julia Pataky were diligent and persevering in providing excellent research assistance. Any errors or omissions are the responsibility of the author alone.

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